TAX INFORMATION BULLETIN

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Inland Revenue
Te Tari Taake

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This is an Inland Revenue service to people with an interest in New Zealand taxation.

Terminal tax – reminder for 7 January 1999 due date

As a simplification measure the Government moved the due date for provisional tax and terminal tax from 7 January to 15 January, and for PAYE and specified contribution withholding tax from 5 January to 15 January.

It is important to note that the amendment to the due date for terminal tax applied from the 1998-99 and subsequent income years. This means the due date for terminal tax due in January 1999 is still **7 January 1999**.

January provisional tax payments relating to the 1999-2000 income year will be due on 15 January 2000.

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New tax legislation passed

Taxation (Simplification and Other Remedial Matters) Bill

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The Taxation (Simplification and Other Remedial Matters) Bill was introduced into Parliament on 25 June 1998 and became law on 7 October 1998 with the enactment of the:

- Taxation (Simplification and Other Remedial Matters) Act 1998 *(98/101)*
- Accident Rehabilitation and Compensation Insurance Amendment Act 1998 *(98/102)*
- Child Support Amendment Act 1998 *(98/103)*
- Social Security Amendment Act (No.3) 1998 *(98/104)* and
- Student Loan Scheme Amendment Act (No.2) 1998 *(98/105)*.

The changes introduced in these Acts constitute a major simplification of the tax system.

Under the present tax return filing system, many employees are required to file an annual IR 5 tax return showing income received throughout the year and rebates claimed. About 1.2 million taxpayers file IR 5 returns each year. Employers have related responsibilities, including filing an annual reconciliation to balance the PAYE deductions they have made during the year and providing each employee with a tax deduction certificate showing the income earned and the tax deducted. About 200,000 reconciliations are filed each year.

The legislative amendments made in this Act remove these obligations. Instead Inland Revenue will create income statements from the information supplied by employers. We will automatically send an income statement to these people:

- certain people with a student loan
- those who receive, or are entitled to receive, family assistance
- those who have had the PAYE or resident withholding tax (RWT) rules applied incorrectly.

Income statements will be pre-printed with taxpayers' wage and salary information and related details.

Consequential amendments have been made to child support, family assistance and the student loan scheme to allow use of income statements and the information they contain for purposes of administering these schemes.

A new employer monthly schedule will combine on a simple form all information currently provided by employers to Inland Revenue. Large employers will be required to provide information electronically, and small employers will be encouraged to do so in the future. The monthly schedules will be used to identify employees' invalid IRD numbers and incorrect use of tax codes.

Taxpayers claiming donation and housekeeper-childcare rebates will complete a new annual rebate claim form. The extra-pay rebate has been repealed.

A number of supporting amendments improve the accuracy of the PAYE system, removing the need to reconcile deductions by means of tax returns:

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- A simplified employee declaration form will replace the IR 12 and IR 13 tax deduction certificates. Employees will have to complete this form only when they start work with a new employer or change their tax code.
- Easier tax codes will be used to help employees select the correct PAYE code for use during the year.
- The PAYE non-declaration rate for taxpayers who do not give employers their tax code and/or IRD number will be increased from 33% to 45% from 1 April 1999.
- For people who receive income tested welfare benefits the requirement to provide an IRD number has been tightened, although there will be an exemption in cases of sickness, injury or disability. A matching provision is proposed to prevent cessation of a benefit payment if a beneficiary has failed to provide an IRD number.
- The tax codes for casual agricultural workers, shearers and shearing shed hands have been replaced with a single tax code Casual Agricultural Employee (CAW). This code has a flat rate of 21%. This will affect employees currently using the casual agricultural worker, the shearer and shed-hand codes. The election day worker code will be retained but increased to equate with the middle effective marginal tax rate.

Other amendments improve the accuracy of the resident withholding tax rules and various social policy measures administered through the tax system:

- Taxpayers will be able to elect a new 33% RWT rate.
- The non-declaration rate for taxpayers who do not give their bank their IRD number will increase from 33% to 45% from 1 April 2000.
- Resident withholding tax (RWT) certificates issued by banks will contain a statement reminding taxpayers that they need to request an income statement if insufficient tax has been deducted.
- Inland Revenue will allocate IRD numbers to children in relation to whom social policy claims are made. This will help ensure the correct provision of the various social policy measures applied through the tax system.
- Overpayments of family assistance will be recovered from the current year's entitlement.
- Refunds exceeding $50 must be requested by taxpayers who receive income statements.

A number of minor consequential amendments were also made.

Section references in the legislative commentary in this Tax Information Bulletin are to the Tax Administration Act 1994, unless otherwise specified.

Background

The changes enacted by this legislation were first put forward in December 1997, in the Government discussion paper *Simplifying Taxpayer Requirements*. The discussion paper put forward proposals to eliminate the IR 5 tax return and reduce compliance costs imposed on taxpayers.

These changes will have a major influence on the volume and types of services the tax administration undertakes in the future. This will free Inland Revenue from the requirement to process millions of tax returns, allowing us to upgrade our technology and provide better services to all taxpayers.

The new system of reduced tax return filing will be particularly critical for employers, who are fundamental to the success of the reform and whose compliance costs may increase temporarily during the transition. For this reason, Inland Revenue plans to work closely with employers during the transition.

Key features

Employer monthly schedule introduced

Employers will be required to provide Inland Revenue with monthly schedules detailing each employee's salary and wage income and deductions such as PAYE, student loan repayments, child support payments and certain other information. They must also fill in a remittance certificate that summarises the schedule and provides required employer details.

The employer monthly schedule process involves:

- combining in one schedule all employee information now provided by employers on multiple forms
- providing earnings and deduction information at an individual employee level
- removing the current year-end reconciliation undertaken by employers.

Employers who use manual payroll systems will be required to copy information already contained in their wage books onto the employer monthly schedule. Employers whose gross annual PAYE and specified superannuation contribution withholding tax deductions were $100,000 or more in the previous tax year will be required to provide information electronically, although a limited exemption is provided if this would cause undue compliance costs.

Improved accuracy of PAYE system

Reduction in return filing is significantly dependent on the accuracy of the PAYE system. Therefore various supporting measures have been introduced, such as clearer tax codes to make it easier for taxpayers to select the correct PAYE code. Inland Revenue will use the information provided by the monthly employer schedule to ensure the correct tax code is being applied and that taxpayers are receiving the correct amount of social assistance for that year. If an employee does not correct an incorrect tax code Inland Revenue will have the authority to request the employer to correct the code.

The non-declaration rate applying to wages and salaries will be increased from 33% to 45%. This rate will apply when employees do not provide their IRD number or choose a tax code.

Improved accuracy of RWT system

Taxpayers will be able to select a 33% RWT rate. This option allows those with income over $38,000 to choose a RWT rate that matches their marginal tax rate. This measure will apply from 1 April 1999. A supporting measure, the introduction of a new 45% non-declaration rate, will apply from 1 April 2000.

Income statements introduced

The new Part IIIA introduces income statements, to replace the annual IR 5 return.

Income statements will be sent mainly to people who have a student loan, or receive family assistance or are entitled to receive it. Income statements will also be sent to taxpayers who have had the PAYE rules applied incorrectly or had their tax under-deducted as a result of using inappropriate tax codes.

Inland Revenue will be publicising the fact that all taxpayers will have the right to request an income statement or an earnings certificate, which will allow them to determine whether they have had tax over-deducted. Taxpayers who do not receive an income statement from Inland Revenue and who do not meet the non-filing criteria will be obliged to request one.

Taxpayers will still be obliged to report untaxed income.

Individual return filing (IR 3 returns)

Taxpayers who earn income that does not have tax deducted at source, such as business or rental income, will be required to complete an individual income tax return. Those who earn wage, salary, interest and dividend income but have something out of the ordinary, such as a loss, will also be required to file a tax return.

Rebates

A separate rebate claim form will remove the housekeeper-childcare and donations rebates from the current return assessment process. The existing maximum and minimum claim thresholds will continue to apply.

This change provides a process for delivering these rebates independently of the tax system and will also apply to individual return (IR 3) filers. The rebate claim form will be completed by taxpayers after the end of the income year and be due no later than 30 September.

The amount of donation and housekeeper-childcare rebates will be limited, as at present, to the extent of a taxpayer's taxable income. Because the information contained on the income statement may be provided after a taxpayer fills in a rebate claim form, the amount of rebate allowed will depend on the previous year's taxable income.

The extra-pay rebate has been repealed with effect from the income year beginning 1 April 1999.

Social policy measures

The amended section KD 5 of the Income Tax Act 1994 (ITA) provides for the allocation of IRD numbers to children for whom family assistance is being claimed. Section 14 of the Child Support Act 1991 has been amended to provide for the allocation of IRD numbers to children for whom child support is being claimed. Income statement information may also be used to determine entitlement for social policy measures administered through the tax system. This will remove the current need for taxpayers to provide income information which is also used for income tax purposes.

To help provide equity between those who correctly estimate their entitlement to family assistance and those whose family assistance is overpaid, section 173 has been repealed and section MD 1 has been amended so that overpayments in a prior income year will be recoverable from the current year's entitlement. The information received from the employer monthly schedule will also allow Inland Revenue to monitor taxpayer income and identify possible overpayments and underpayments of family assistance.

Recovery from current year payments of family assistance will not occur if the result would be serious hardship. This measure will apply from 1 April 2000.

Application date

The PAYE-related amendments will apply from 1 April 1999. The measures relating to income statements will result in the last IR 5 returns being filed for the income year ending 31 March 1999.

The first income statements will be issued in late May 2000. The family assistance and child support amendments relating to the provision of IRD numbers for children will apply from 1 April 1999.

Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Bill

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The Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Bill was introduced on 24 March and became law on 26 November. One of the two main reforms in the bill, the introduction of a tax credit system for taxing income from superannuation fund and life office savings, did not proceed to enactment. The passage of the bill through Parliament resulted in the enactment of the:

- Taxation (Tax Credits, Trading Stock, and Other Remedial Matters) Act 1998 *(98/107)*
- Student Loan Scheme Amendment Act (No.3) *(98/108)* and
- Taxation (Annual Rates of Income Tax 1998-99) Act 1998 *(98/109)*.

The main feature of the new legislation is the reform of the rules for valuing trading stock for tax purposes - to make them clearer and more consistent, and measure income more accurately.

Income statements

Sections 3, 4A, 15B, 33, 33A, 37, 38, 43, 47, 80A-I, 89C, 89D, 106, 108, 110, 111, 120C, 143, and 184A Tax Administration Act 1994
Sections KD 1, KD 6 and NC 16, Income Tax Act 1994

Individuals not required to file a return or receive an income statement

Section 33A has been replaced with a new section which redefines those individuals who will not have to file a tax return. The new section also excludes most individuals from being automatically issued an income statement.

The individuals affected by these changes include those who do not derive income from sources other than from employment, which is subject to PAYE, and interest and dividends, which are subject to RWT. This is because the changes to the existing withholding rules result in these rules being sufficiently accurate to allow certain individuals to avoid an end-of-year income tax square-up.

Under new section 33A(1) individuals do not have to file a return or receive an income statement if they received $200 or less of gross income that has had tax deducted incorrectly. This $200 threshold will prevent unnecessary compliance and administrative costs in situations where minor errors have occurred. It also applies to non-New Zealand sourced interest or dividends that have had foreign tax deducted at source.

To avoid the obligation to file a return or receive an income statement, individuals or their spouses must also meet other criteria:

- They must not have been issued with a family certificate of entitlement for any part of the income year or received a family credit (under section KD 6 of the ITA) for which abatement is required.
- They must not have a student loan balance at the end of the income year.

Taxpayers who meet these criteria and do not receive an income statement must request one. This is because the withholding rules cannot accurately account for the fact that they are subject to various social policy measures administered through the tax system.

Individuals required to file a return

New section 33A(2) and (3) specifies those individuals who must file tax returns, because the complexity of their affairs requires an end-of-year square-up. The following "natural persons" will have to file a return:

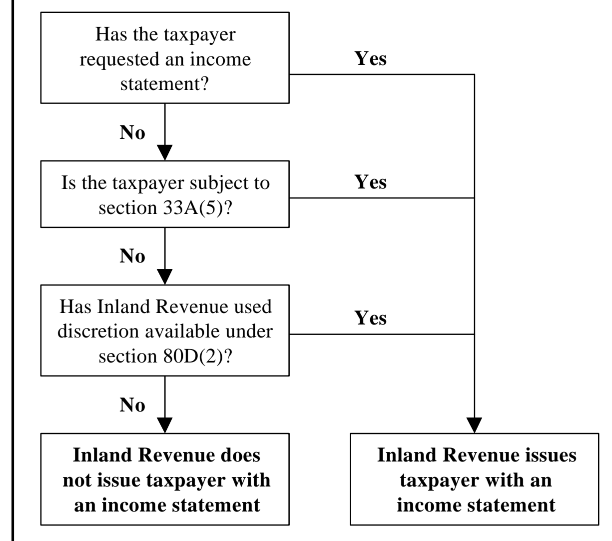
- absentees
- provisional taxpayers
- those who are not cash basis holders
- those who received withholding payments or beneficiary income
- those who receive gross income as a private domestic worker ("IR 56 taxpayers").

A tax return must also be filed for taxpayers who have died.

Natural persons must also file a return if they have made a net loss for that income year, have an available net loss to offset against their net income, held a certificate of exemption at any time during that year, or are subject to section 44. That section allows the Commissioner to demand special returns or make special assessments in certain circumstances.

New section 33A(4) states that unless the new section 80D applies, Inland Revenue is not permitted to issue an income statement to individuals referred to in section 33A(1).

Figure 1: taxpayers who will receive an income statement



New section 33A(5) states that Inland Revenue must issue an income statement to all individuals to whom sections 33A(1) and (2) do not apply if they have not been issued with one by the appropriate date.

Persons required to receive income statements

The new Part IIIA, containing sections 80A to 80I, details the requirements regarding income statements. Income statements are being introduced to allow an end-of-year income tax square-up if the withholding rules do not deal with certain complexities or an individual is subject to various social policy measures administered through the tax system.

Section 80A lists those taxpayers to whom Part IIIA applies. They include taxpayers not exempted from the obligation to be issued with an income statement by section 33A(1) and taxpayers who must file a tax return

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under section 33A(2). The section also applies to those who have requested an income statement.

Section 80B requires individuals to notify Inland Revenue if they have received an income statement but should not have. This notification must either be before 7 February or before their terminal tax date, depending on whether section NC 17 of the ITA applies. Section NC 17 states that income tax is due and payable on 7 February unless otherwise specified.

Section 80C requires taxpayers to notify Inland Revenue if they are required to be issued with an income statement but do not receive one. This notification must be either before 7 February or before their terminal tax date, depending on whether section NC 17 of the ITA applies.

Section 80D obliges Inland Revenue to issue income statements to all appropriate individuals identified in Part IIIA. It also gives Inland Revenue authority to issue income statements to individuals to whom this part would not otherwise apply. It also allows for Inland Revenue to issue more than one statement to a taxpayer for a given income year and provides that an income statement issued under this section must contain the details set out under section 80E.

Particulars to be included in income statements

Section 80E lists the details to be included in all income statements issued under Part IIIA:

- the amount of income from employment, interest or dividends
- the amount of any tax deducted from that income (when this information is available)
- the source of any such income
- the amount of earner premium deducted

If appropriate, the income statement will also include a calculation of the person's income tax liability, including any tax payable or refund due.

Taxpayer obligations and assessment when income statement received

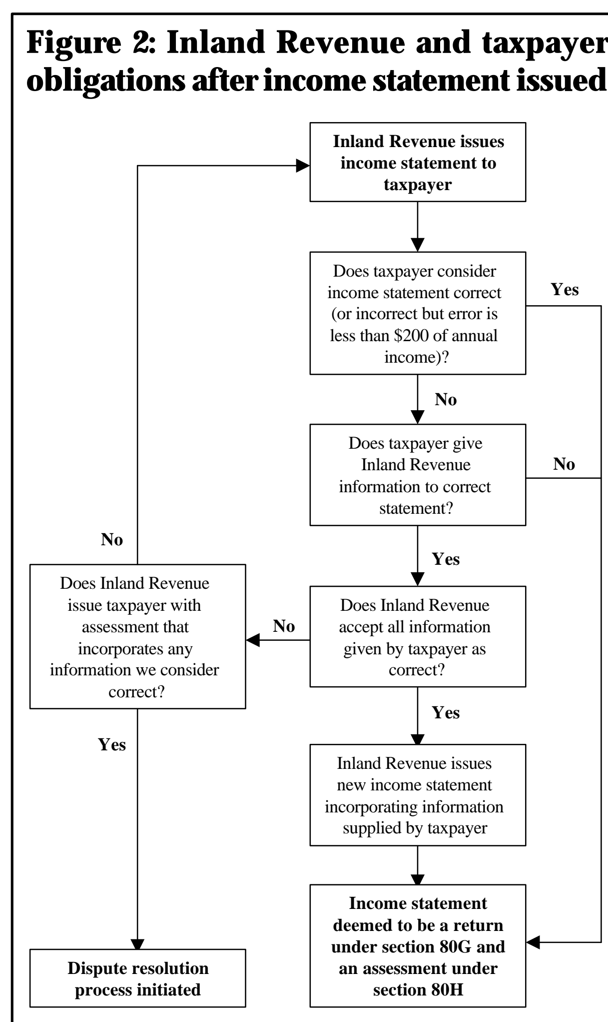
Section 80F outlines Inland Revenue's and individual taxpayers' obligations once an income statement has been issued. It stipulates that if total income from employment and/or interest and/or dividends not shown on the income statement is $200 or more, individuals must notify Inland Revenue that the income statement is incorrect. They must then give Inland Revenue the information they consider to be correct.

Individuals to whom section NC 17 of the ITA applies must supply the information they consider to be correct by the later of 7 February in the next income year or 30 days after the date of issue of the income statement. Individuals not covered by section NC 17 must supply the correct information by the later of the terminal tax date or 30 days after the issue of the income statement. These dates are used because they give taxpayers enough time to reply to Inland Revenue once an income statement has been issued.

If Inland Revenue considers all of the information provided by a taxpayer under section 80F(1) to be correct, we must issue another income statement incorporating this information. This provides confirmation that we regarded the information supplied by the taxpayer as correct.

If Inland Revenue considers that some or all of the information supplied by an individual under section 80F(1) is incorrect, we either issue another income statement incorporating the information which we consider correct or an assessment. The option of issuing an assessment rather than another income statement enables the dispute resolution process to begin.

Figure 2: Inland Revenue and taxpayer obligations after income statement issued



Income statement deemed return of income and general assessment

Sections 80G and 80H allow for an income statement to be deemed a return of income and a general assessment. This is necessary because numerous provisions in the ITA refer to returns of income and general assessments. Therefore, for the proposed amendments to function correctly, these provisions are required.

If an income statement is either accepted by a taxpayer as being correct, or not accepted as being correct but the taxpayer does not respond in the manner prescribed in section 80F, the income statement is deemed to be a return of income.

Section 80H states that an income statement is deemed to be a return of income under section 80G and will also be deemed to be a general assessment. Unless an income statement indicates that a small refund is due, it becomes a general assessment on the earlier of 7 February or a taxpayer's terminal tax date, depending on whether section NC 17 of the ITA applies. If a refund of $50 or less is due, an income statement becomes a general assessment on the earlier of the date on which the taxpayer requests a refund, or 30 days after the date of issue of the income statement. This allows taxpayers adequate time to consider whether the income statement is correct and, if not, provide Inland Revenue with any information they consider necessary to correct the income statement. Once assessed the refund will be issued automatically.

The amended section MD 1 of the ITA states that taxpayers who receive an income statement that indicates they are due a refund of more than $50 must contact Inland Revenue to confirm that they have verified the accuracy of their income statement in order to receive the refund. This confirmation will be able to be done via a toll free telephone service. Once this confirmation has been received the refund will be paid into the taxpayer's bank account.

If an income statement is issued either immediately before 7 February or a taxpayer's terminal tax date, it is desirable to allow that individual adequate time to provide Inland Revenue with any necessary corrections. Therefore if an income statement is issued less than two months before these dates the taxpayer will have two months before that income statement becomes a general assessment.

Supporting amendments

Further supporting amendments have been made:

- A new section 106(1A) has been inserted. This allows an assessment to be made for an amount of tax that Inland Revenue considers ought to be imposed, when an income statement that Inland Revenue considers to be incorrect or incomplete is issued to a taxpayer.
- A new section 108(1A) has been inserted. This stipulates that, unless section 108(2) or section 108B applies, an income statement cannot be issued four years after the end of the income year which follows the income year to which the income statement would apply.
- A new section 184A provides that refunds must be made electronically unless it would cause undue hardship to a taxpayer or is not practicable. This provision applies from 1 April 2000.
- Section 120C has been amended to allow the compliance and penalties interest regime to be applied to income statements. It deems the income statement's lodgement date (used for interest calculations) to be the date on which the statement is issued.

These amendments extend the current rules relating to tax returns to the income statements replacing these returns.

Earnings certificate

A further feature of the changes is the introduction of an "earnings certificate". This is a supporting administrative measure so no legislative authority is required.

Employees will be able to request an earnings certificate as a record of their income for the year. This is being introduced because of the changes to employers' data filing requirements. Along with the advent of the employer monthly schedule and the removal of the requirement on employers to undertake end-of-year reconciliations, employers will no longer be required to provide IR 12 and IR 13 tax deduction certificates. Therefore, because Inland Revenue will possess all the necessary information, we can give employees a record of their annual gross employment income.

An earnings certificate will detail an individual's wage and salary income and PAYE deductions, but unlike income statements it will not show any tax calculations and will not be deemed to become a return of income or general assessment.

Rebate claim form

Sections 41A and 184A, Tax Administration Act 1994
Section KC 4, KC 5 and NC 17, Income Tax Act 1994

Eligibility rules

The existing rebate eligibility rules remain unchanged, including the maximum rebate entitlements. Receipts will continue to be required for donation rebates but not for housekeeper-childcare rebate claims.

Currently rebates which may be claimed are limited to the amount of tax payable in any given year. The new section 41A limits the amount of gross payments upon which rebates could be claimed to taxable income in the preceding income year. Limiting the rebates claimed to the previous year's taxable income is necessary because of the change incurred from moving from tax returns to income statements. Otherwise taxpayers would not necessarily know their tax positions without tax returns, and the taxable income information for the current year would be unlikely to be available before the rebate was claimed.

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Limiting the allowable rebates to the previous year's taxable income also applies to individual return filers.

Rebate claim form

The current legislation allows salary and wage earners to claim rebates on an annual tax return. From 1 April 1999 annual tax returns for salary and wage earners will no longer exist. Instead the new section 41A allows individual taxpayers to claim rebates using a rebate claim form. Claiming rebates through a tax return has no link with one's income tax position, so at present taxpayers must incur the compliance costs associated with completing a tax return or checking an income statement merely to claim a rebate.

Taxpayers may apply for one or more refunds of qualifying payments (under section KC 4 of the ITA) or gifts

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(under section KC 5) by using the rebate claim form. This form will take effect from 1 April 1999, although taxpayers will not be able to claim rebates relating to the 1999-2000 income year until 1 April 2000.

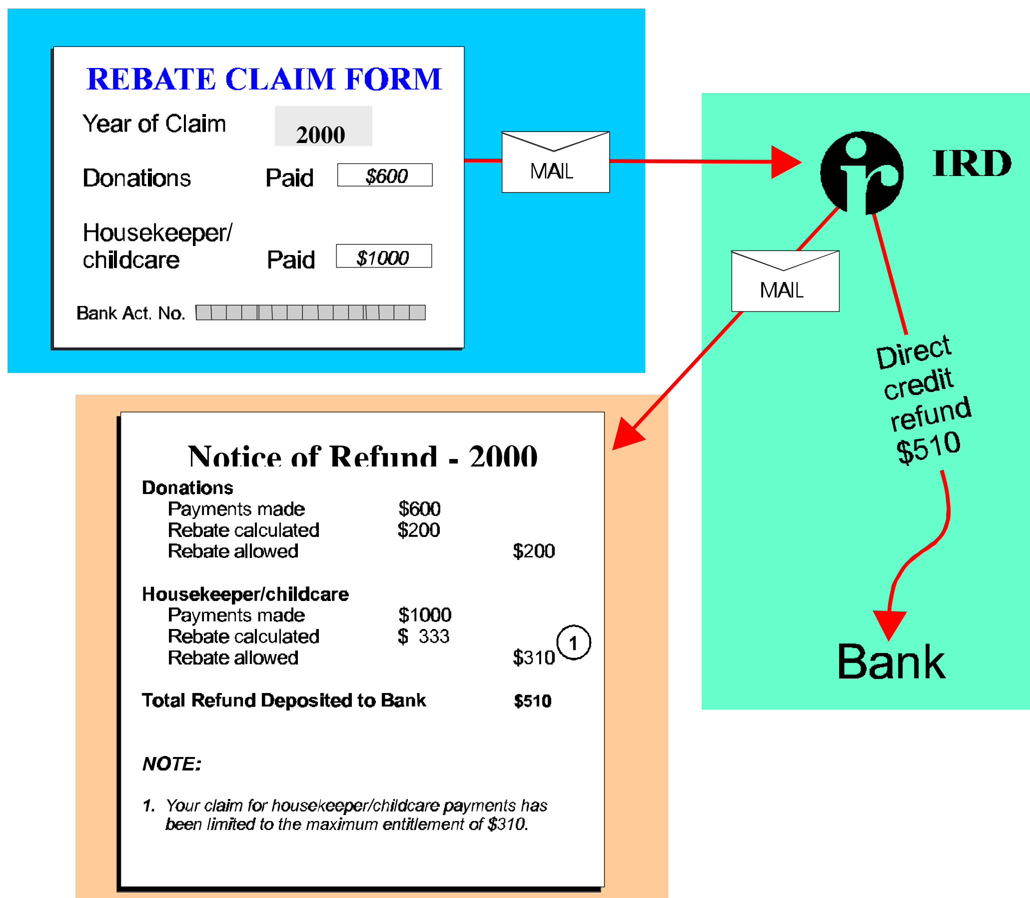
All rebate claim forms for an income year must be filed by 30 September of the following income year. The rebate claim form will be used by all individuals who are eligible to claim rebates, including those who will still be required to file a annual tax return.

Rebate claim notice

When Inland Revenue has processed a rebate claim form the new section 41A requires us to issue a rebate claim notice to inform the taxpayer of the amount of donation or housekeeper-childcare rebates allowed and the amount of the refund allowed. This refund will be deposited into the taxpayer's nominated bank account.

Figure 3: The rebate claim process

In June 2000 a taxpayer completes a rebate claim form claiming donations of $600 and housekeeper-childcare costs of $1,000 for the income year from 1 April 1999 to 31 March 2000. The entitlement is based on taxable income for the year ended 31 March 1999.



In this example, the taxpayer has claimed $200 of a $500 maximum donations claim and the maximum $310 housekeeper-childcare rebate.

Because Inland Revenue received a claim for the 2000 income year, we will issue a blank rebate claim form automatically in the year 2001.

Refundable credits

The new section 41A requires that any refunds allowed under sections KC 4 or KC 5 of the ITA must be paid to the taxpayer as if they were tax paid in excess. This links into the new section 184A, which requires that any refund of tax paid in excess must be made by electronic means to a bank account nominated by the taxpayer. Direct crediting refunds decreases compliance costs for taxpayers (saving them the expense of banking a cheque) and decreases administrative costs for Inland Revenue. Nevertheless, it may sometimes be necessary to issue a refund by cheque, so subsection (3) of section 184A allows for an exemption to this rule if a taxpayer experiences undue hardship complying with section 184A. Issuing refunds manually will be considered on a case-by-case basis.

Section KC 4 of the ITA is being amended to allow refunds for housekeeper-childcare rebates to be made only if section 41A is complied with. To comply with section 41A, taxpayers will need to complete the rebate claim form as prescribed by Inland Revenue. The form has to show the correct details of rebates being claimed, along with receipts (if required), and be signed by the taxpayer.

Section KC 5 of the ITA is being amended to allow refunds for gifts of money to be made only if section 41A is complied with.

Extra pay rebate

The extra pay rebate compensates taxpayers for loss, in an annual assessment, of the rebates allowed in any extra pay-period or periods. The rebate is available to employees who receive more than 52 weekly full and regular pays in an income year. Granting this rebate is discretionary under present law.

The extra pay rebate has been removed by amending section NC 17 of the ITA, repealing the provision from the income year commencing 1 April 1999. Under the existing system, employers enter the number of pays employees receive during a year on their tax deduction certificate. The new legislation removes the existence of the tax deduction certificate, thus removing the avenue of communication to Inland Revenue as to which employees received an extra pay. Removal of the extra pay rebate also corrects an administrative inconsistency because this is the only rebate that is discretionary.

Improvements in accuracy of PAYE system

Sections 81 and 82A, Tax Administration Act 1994
Sections NC 8, NC 12A, NC 15 and Schedule 19, Income Tax Act 1994

Tax codes

Section NC 8 of the ITA will be amended to provide new tax codes that are simple and self-explanatory. The significant changes to the tax codes are set out in Table 1.

The fundamental change for employees is that those currently using the G tax code will now use the M tax code and employees currently using the G ED tax code will now use the M SL tax code.

Selecting the correct tax code reduces the need for employees to “square-up” any end-of-year tax, which will result in compliance cost and administrative savings. Changing the tax codes to make them clear will assist employees to choose the correct tax code the first time.

Employees using incorrect tax codes

The new section NC 12A of the ITA allows Inland Revenue to inform employers that employees are using incorrect tax codes. An employer who receives notification of the correct tax code must apply that tax code to source deduction payments on behalf of the employee. Tax codes amended by Inland Revenue Department will cease to apply from the last day of the year in which we notified the employer of the correct tax code.

Table 1: New tax codes

New Code	Description	Equivalent present code
M	Main source of income. Only one job can have this code.	G
M SL	Main source of income with a student loan. Only one job can have this code.	G ED
ML	Main source of income if annual taxable income is less than $9,880 a year from all sources. To use this code the employee must work full-time (more than 20 hours per week).	T
S	Secondary sources of income if annual taxable income is less than $38,000.	SEC
SH	Secondary sources of income if annual taxable income is higher than $38,000.	
S SL	Secondary source of income if taxpayer's annual taxable income is less than $38,000 and he or she has a student loan.	SEC ED
SH SL	Secondary sources of income if annual taxable income is higher than $38,000 and he or she has a student loan.	
STC 99	Special tax code rate issued by Inland Revenue (99 indicates the special tax code rate in cents per dollar).	IR 23

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Employees can advise their employers of a change in tax codes by using the employee declaration form.

Employee declaration form

Section NC 15 of the ITA will be amended to eliminate tax deduction certificates, which at present inform the employer as to an employee's tax code. An alternative source of information is the employee declaration form, which is linked to section NC 8 of the same Act. The purpose of this form is for employees to formally declare their name, address, IRD number and tax code. Employees will be required to complete the employee declaration form only when their tax code changes.

Tax codes for special circumstances

Section NC 8 of the ITA has been amended to simplify the tax codes used for the following special employment types:

- casual agricultural workers
- shearers
- shed hands.

The current tax codes for these workers (CAW, SHR, and SSH) will be replaced by a single tax code, casual agricultural employee (CAE). This code will have a flat rate of 21%. The rate of 21% is used to bring it in line with the middle effective marginal rate, and therefore avoid the need for these taxpayers to request an income statement unless they earn more than $38,000. Initially the Government presented the removal of these codes in the *Simplifying Taxpayer Requirements* discussion document. However, because of the concerns raised relating to inaccurate deduction and compliance costs, a tax code for these special employment types has been retained.

The special tax code for election day workers (EDW) is to be retained because removing it would create considerable compliance costs for the Chief Electoral Office and local bodies. However, the deduction rate for election workers has been increased from 20% to 21%, and clause 7B of Schedule 19 is being amended to reflect this change. The change to a 21% deduction rate will bring this tax code into line with the middle effective marginal tax rate.

Non-declaration rate

Clause (2) of Schedule 19 has been amended to include the new non-declaration rate of 45% when section NC 8 of the ITA applies, with effect from 1 April 1999. The increase to 45% will allow for sufficient deductions to be made when taxpayers do not provide a correct IRD number and have social policy responsibilities, and their total income exceeds the top tax rate threshold of $38,000.

Work and Income New Zealand exempt from applying new non-declaration rate

The Social Security Act 1964 requires WINZ to pay beneficiaries a net rate of benefit, which cannot be reduced. If WINZ were to apply the 45% non-declaration rate its PAYE liability would increase but the net benefit would not alter. This could result in some beneficiaries requesting an income statement and claiming the additional PAYE back, which effectively increases their net benefit.

Similar problems arise with the taxation of student allowances, which WINZ will administer from 1 January 1999.

For this reason the legislation exempts WINZ from applying the non-declaration rate of 45% to income-tested benefits and student allowances.

Beneficiaries must supply WINZ with IRD number

WINZ will be exempted from applying the non-declaration rate of 45%, although the provisions for beneficiaries providing a correct IRD number to WINZ are being tightened. The current exemption requires beneficiaries to provide their IRD number within four weeks of applying for a benefit or being asked for their IRD number. If the IRD number is not provided, the Chief Executive of Department of Work and Income may refuse to grant or suspend the benefit applied for until the information is supplied.

New section 10AA is being added to the Social Security Act 1964. This section obliges applicants for welfare benefits to provide evidence of a correct IRD number. They must do this within ten working days after the date of application for the benefit or the date that the WINZ Chief Executive requests the IRD number. The Chief Executive may decline or suspend an application for a benefit if an applicant's IRD number is not received within the ten working day limit. An exemption is given under subsection (6) of this section which exempts beneficiaries in cases of sickness, injury or disability from providing their IRD number within the ten working day period.

Exchange of IRD number information between Inland Revenue and WINZ

The new section 82A authorises the exchange of information between Inland Revenue and WINZ to ensure beneficiaries' correct IRD numbers are supplied, to prevent cessation or suspension of benefit payments.

This section will apply only after section 10AA of the Social Security Act 1964 has failed. Subsection (5) of section 82A states that if a beneficiary is identified, Inland Revenue may supply the IRD number of the

beneficiary to a person authorised under the new paragraph (n) of section 81(4). Paragraph (n) refers to a person who is an officer, employee or agent of WINZ.

Nominated persons

Section 81(4)(l) has been amended to allow a person who nominates another person to take care of their tax affairs on their behalf to make a nomination by telephone as well as in writing. This has been changed because of Inland Revenue's increased reliance on telecommunications systems.

The systems will be designed so that security of a taxpayer's affairs is maintained by the use of confidential passwords. In order to operate as a nominated person an individual will be required to know the password of the person they are acting on behalf of. A number of questions will be asked over the phone to ensure correct identification of person nominating a person to act on their behalf. A letter will be issued to a person nominating a person to act on their behalf to confirm the nomination of person, to provide a further check on the nomination, and to provide a permanent record to the taxpayer.

Employer PAYE obligations

Sections 3, 23, 35, 36, 36A-E, 40, 46, 48, 139A, 139AA, 142, 142G, 168, 183A, 183D, Tax Administration Act 1994
Sections LD 1, NC 15, NC 18 and OB 1, Income Tax Act 1994

The employer monthly schedule

Section NC 15 of the ITA has been amended to provide for employer monthly schedules to replace the existing PAYE returns (IR 66N or 66W). The employer monthly schedule will contain the following information (as defined in section OB 1 of the same Act) that must be filed monthly:

- name and IRD number of each employee
- the tax code of each employee
- the amount of gross earnings, total amount of tax deductions, and amount of earnings not liable to the earner premium for each employee
- particulars of child support and student loan deductions
- if employees started or stopped work in that month
- indication of employees for whom the tax deducted from an extra emolument is at a rate less than 33%
- any errors identified by the employer, provided the error is detected before the final employer monthly schedule for the income year is submitted.

Section NC 15(1)(a) has been amended so that twice monthly filers will continue to pay source deduction payments, child support deductions and student loan deductions made in the first PAYE period by the 20th of the month in which the deductions were made. The requirement to provide the details (outlined in the definition of "employer monthly schedule" in section OB 1 of the ITA) for that period has been removed. Employers will be required to provide a remittance certificate showing only the total amounts of tax deductions, child support deductions and student loan deductions made in the first PAYE period. Remittance certificates will be able to be lodged electronically.

The details of all individuals' deductions made in a particular month (outlined in the definition of "employer monthly schedule" in section OB 1 of the ITA) will be required by the 5th of the following month, along with payment for twice monthly filers.

Current monthly filers will continue to provide the employer monthly schedule and payment in full by the 20th of the month following the month in which the deductions were made.

Employers who file paper employer monthly schedules must complete a form prescribed by Inland Revenue.

Tax deduction certificates eliminated

Employers' obligation to retain tax deduction certificates has been removed from section NC 15 of the ITA. This removes the need for employers to send a copy of the tax deduction certificate to employees and file the tax deduction certificates with the PAYE reconciliation (IR 68P).

The new return filing process

Figure 4 illustrates the current and the new filing requirements for employers. This new process will differ for employers operating a manual payroll system and those operating a computer payroll system.

Employers are to continue to file an annual ACC employer premium reconciliation statement (IR 68A)

Section NC 15 of the ITA has been amended to remove the reference to employers having the obligation to file an ACC employer premium reconciliation statement. This obligation will still exist for employers, but is now in the amended regulation 3 of the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992.

Regulation 12 of the Accident Rehabilitation and Compensation Insurance (Earnings Definitions) Regulations 1992 will be revoked and replaced with a regulation that obliges employers to provide ACC employer premium statements by the 15th of the second month after the month an employer ceases or disposes of a business. Payment of employer premium must also be made by this date.

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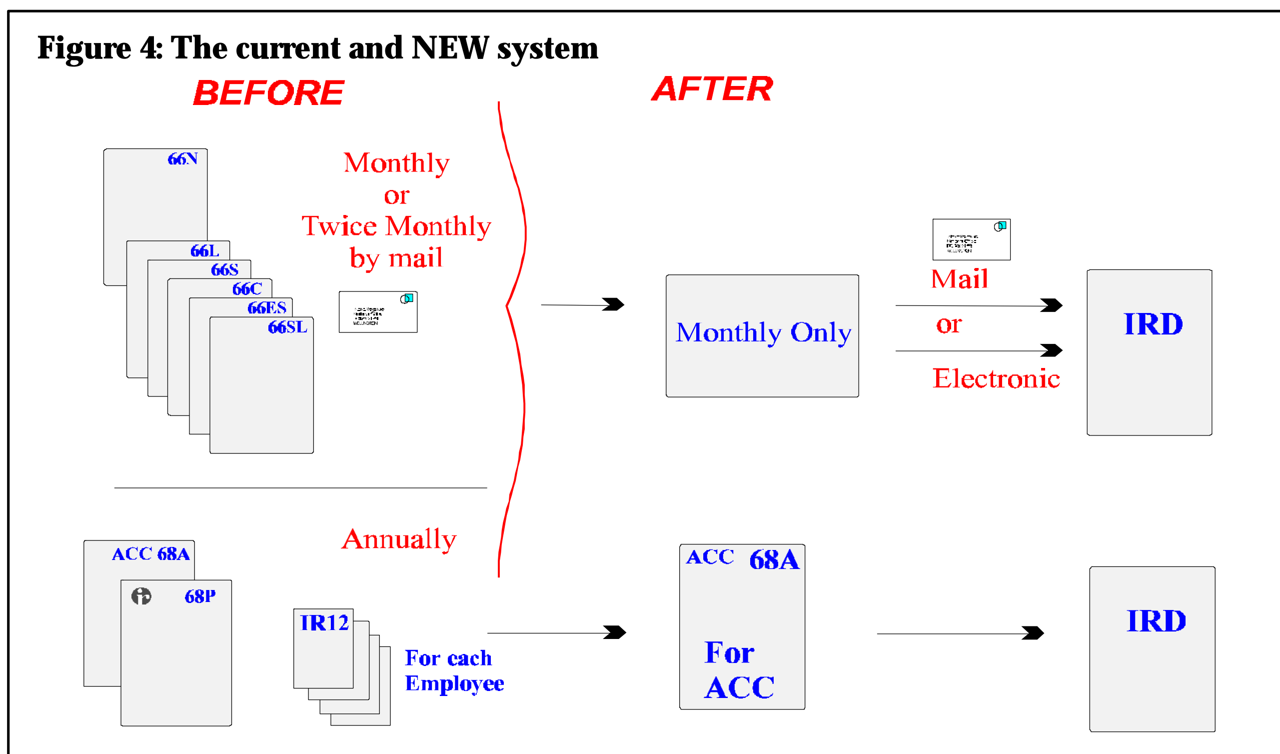

Figure 4: The current and NEW system

Electronic filing

The new section 36A makes electronic filing of the employer monthly schedule by certain employers compulsory, and the data must be transmitted in a prescribed electronic format, except for those employers who are exempt under the new section 36B.

Subsection (2) of section 36A gives employers the option of transmitting the remittance certificate in an electronic format. Employers who choose to transmit it electronically must do so in a format prescribed by Inland Revenue.

The exemptions outlined in section 36B relate to employers who have accounting systems that are incapable of providing the employer monthly schedule in an electronic format. Compliance costs and the number of employees are factors that will be taken into consideration in determining if an employer can electronically transmit the employer monthly schedule.
Section 36B(2)(c) and (d) states that an exemption from filing the employer monthly schedule electronically will be given only to employers of 100 or fewer employees. This threshold will decrease to 50 employees from 1 April 2000.

The new section 36C states that information required to be furnished electronically must be in a prescribed electronic format that is certified by Inland Revenue. Subsection (2) applies to employer monthly schedules, forms and returns that are furnished in an electronic format. It will suffice for Inland Revenue to produce a printed copy of a specification of an electronic format in a court of law as evidence that an electronic format was prescribed. Taxpayers will not be required to retain a paper copy of the employer monthly schedule.

Employers who are required to file their schedules electronically will have two options for transmitting their data – electronic file transfer or by completing an electronic form. These two options will operate through Inland Revenue's website through either an internet service provider's connection or through a virtual private network (Xtranet).

Employers who use the electronic file transfer option will send a file which their payroll software has created into a monthly schedule.

Employers who choose to complete an electronic form will log on and then complete an on-screen version of the paper employer monthly schedule. (The paper employer monthly schedule will be used by employers who do not have to file electronically.) As with the paper copy, the employer will have to fill in all employee details on the first schedule. Subsequent copies will have the employer's and employees' general details already completed.

There is no change to the way employers will make their payments. However there are plans for the future introduction of electronic commerce.

Taxpayers who are not required to file electronically but wish to will be able to do so.

Penalty for not filing electronically

The new section 139AA imposes a penalty on employers who are required to file employer monthly schedules in a prescribed electronic format and who fail to do so. This section does not apply to employers who are exempted from filing the schedule in a prescribed format under section 36B(1).

The penalty is the greater of $250 or $1 for each person employed at any time during the month to which the employer monthly schedule relates.

Late filing penalties

Section 139A has been amended to ensure taxpayers who do not file an employer monthly schedule by the required date are liable for the late filing penalty from 1 April 1999.

Subsection (4) of this section sets the penalty for late filing of an employer monthly schedule at $250.

Subsection (5) is amended to allow Inland Revenue to impose a late filing penalty for employer monthly schedule without having to notify the employer that the penalty will be imposed.

WINZ and ACC exemption from providing employer monthly schedule information

Because welfare beneficiaries and ACC claimants are considered to be employees under the law, WINZ and the Accident Rehabilitation and Compensation Insurance Corporation (ACC) will have to complete employer monthly schedules for beneficiaries and claimants. Given the number of people required to be covered by these schedules, it is necessary to grant these two entities a deferral of their obligation to file employer monthly schedules for the period 1 April 1999 to 31 March 2000. These organisations will be required to file one annual employer schedule on or before 5 April 2000. Any further deferral would delay issuing tax refunds and family assistance.

As a result, section 46 will be amended as follows:

- WINZ will not have to provide dates of when beneficiaries began or stopped receiving a benefit until 5 April 2000.
- WINZ will not have to provide family assistance information for beneficiaries receiving a benefit until 5 April 2000.
- The ACC is exempted from providing this information about claimants until the same date.

The exemption is not extended to staff members of these organisations.

Non-resident employees

Section NC 18(2) of the ITA has been replaced by a new subsection (2) which relates to non-resident employees. It provides that if Inland Revenue accepts a bond or other security from an employer in relation to an employee, the employer must not make tax deductions under the PAYE rules; not include the employee's details in an employer monthly schedule; nor apply the non-declaration rate to that employee.

Resident withholding tax changes

Section 25, Tax Administration Act 1994
Sections NF 2A, NF 11 and Schedule 14, Income Tax Act 1994

Deduction rates for RWT

From 1 July 1998 RWT has been deducted from interest income at the rate of 19.5%. This affects taxpayers with income over $38,000 who receive interest income, because their RWT has been under-deducted at the rate of 13.5 cents in the dollar.

The present system encourages taxpayers whose income is over $38,000 not to provide their IRD number to financial institutions so that the current non-declaration rate of 33% is applied to their interest, and the correct amount of tax is deducted. Even so, Inland Revenue still requires the IRD number of each taxpayer for income matching purposes, regardless of whether RWT is being deducted at the correct rate.

To encourage people to use the correct withholding rate and to provide their IRD number, new section NF 2A of the ITA is being introduced, and Schedule 14 is being amended to allow taxpayers to choose to use a 33% withholding rate (as specified by the new section NF 2A).

An election by a taxpayer under section NF 2A will apply to all payments of interest made from the same source. Therefore, an election by a taxpayer to have the high deduction apply will result in all interest payments received from a specific payer of interest being subject to that rate of deduction.

If taxpayers do not choose to use the 33% rate, the default rate of 19.5% will apply, as outlined in clause 1(c) of Schedule 14.

Changes to the non-declaration rate

Clause 1(a) of Schedule 14 increases the non-declaration rate for not providing an IRD number to a financial institution from 33 cents to 45 cents, from 1 April 2000.

RWT certificates

RWT certificates must still contain details of an account holder's total gross interest and the resident withholding tax deducted.

Section 25(6) has been amended to include the extra information required on the RWT certificates. The main changes are found in paragraph (c), which requires that the IRD number of the recipient be printed on the

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certificate, if it is known to the payer. Adding paragraph (c) merely formalises what currently occurs. Another major change to the RWT certificate obliges financial institutions to provide a statement on the certificate stating that taxpayers should contact Inland Revenue if insufficient tax has been deducted from their interest. To enable taxpayers to determine whether tax has been deducted correctly, interest payers will also be required to include a statement of the amount of tax deducted from interest paid at the lower deduction rate, 19.5%. To avoid imposing excessive compliance costs, interest payers will be able to use a formula to estimate the amount of interest taxed at 19.5%.

ACC premiums – year in which deductible

Section ED 1, Income Tax Act 1994

Introduction

Section ED 1 has been amended to ensure that the timing of the deductibility of ACC premiums will not be affected by the extension of the terminal tax due date for taxpayers with a tax agent.

Background

The amendment arose in relation to the tax deductibility of ACC premiums as a result of the two-month extension in the terminal tax date for those taxpayers with a tax agent.

The Finance and Expenditure Committee recommended that this amendment be included in the bill, so it was added at the Select Committee stage, on that recommendation.

Key features

Section ED 1 has been amended by inserting a new paragraph (2A). This paragraph provides that taxpayers who are clients of a tax agent and whose ACC premiums are due and payable more than 12 months after their balance date are allowed a deduction for the premium as if the premium were due and payable 11 months after the end of the balance date. For example, taxpayers with a March balance date who are clients of a tax agent must pay their ACC premium by 7 April. They will be allowed to claim a deduction for income tax purposes as if the premium were due and payable on 7 February.

The due dates for taxpayers with and without a tax agent are set out in schedule 13 of the Income Tax Act.

This amendment will preserve the status quo regarding the timing of the deductibility of ACC premiums. It applies from the 1998-99 income year.

Thin capitalisation – remedial amendments

Sections FG 4(10)-(11), FG 6, FG 9, Income Tax Act 1994

Introduction

Remedial amendments have been made in three areas of the thin capitalisation rules where the original policy intent had not been effected.

Background

The thin capitalisation rules were enacted in December 1995, and apply to taxpayers controlled by a single non-resident person. The rules limit the amount of interest deduction available to the taxpayer if its New Zealand group has an excessive level of debt relative to the worldwide group of which it is a member.

Three areas were identified where the mechanics of the legislation did not achieve its policy intent:

- The rules for determining the New Zealand group did not operate correctly for a company subject to the thin capitalisation rules only by virtue of the "controlled by any other means whatsoever" test.
- The on-lending concession was too narrow, and had the potential to deny an interest deduction twice on on-lent debt.
- Certain deductible interest expense had not been brought within the ambit of the rules.

A further issue was identified and addressed at the Select Committee stage of the bill. The grouping rules did not lead to consistent results if a non-resident with a branch operation in New Zealand also had a 50% or greater ownership interest in a New Zealand subsidiary.

Further background on these issues and a commentary on the amendments made to address them is contained in the Detailed Analysis section below.

For a detailed exposition of the thin capitalisation rules, see TIB Volume Seven, No. 11 of March 1996 (original legislation), and TIB Volume Eight, No. 11 of December 1996 (rules for determining New Zealand groups).

Key features

- Section FG 4(10) has been amended so that when a non-resident has both a branch in New Zealand and a New Zealand subsidiary, only the branch will be treated as being a New Zealand parent.

- An amendment to section FG 4(11) clarifies the rules for determining a taxpayer's New Zealand parent if the taxpayer is subject to the thin capitalisation rules only by virtue of the "controlled by any other means whatsoever" test.
- Section FG 6 has been amended to allow the on-lending concession to apply to funds on-lent to an associated person, if the associated person is subject to the thin capitalisation rules and is not a member of the taxpayer's New Zealand group. A requirement that on-lending be for an arm's length consideration if the concession is to apply has also been introduced.
- Section FG 9 has been amended to include interest expense deductible under sections DD 3, DI 1(1)(a) or (b) and DL 1(3)(c) within the ambit of the thin capitalisation rules.

Application date

The amendments apply from the start of the 1998-99 income year.

Detailed analysis

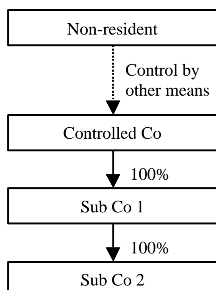
Remedial amendments have been made to three areas of the thin capitalisation rules. The amendments address issues where the original policy intent has not been effected.

Determination of taxpayer's New Zealand group

Companies "controlled by any other means whatsoever"

A deficiency in the rules for identifying a taxpayer's New Zealand group was identified in relation to companies that are subject to the thin capitalisation rules only because of the catch-all control test in section FG 2(1)(b)(ii) – "controlled by any other means whatsoever".

The problem is illustrated in the diagram below. In principle, Controlled Co should be the New Zealand Parent in relation to Sub Co 1 and Sub Co 2, because it is the highest company in the chain of companies to which Sub Co 1 and Sub Co 2 belong. However, because there is not a non-resident person with a 50% or greater ownership interest in Controlled Co, the previous rules in section FG 4(10) inappropriately identified each of the three New Zealand companies to be their own New Zealand Parent.



As a consequence, the three companies could have determined their New Zealand group independently of each other, in a way that minimised the effect of the thin capitalisation rules.

For example, if Sub Co 2 was thinly capitalised (say 100% debt) while the other two companies were not (say 50% debt), the other two companies could have excluded Sub Co 2 from their New Zealand group, to ensure that no denial of interest expense would occur (both companies would have debt percentages below the 75% safe harbour threshold). By contrast, Sub Co 2 could have included the other two companies in its New Zealand group. This would have resulted in a consolidated debt percentage of less that 100%, reducing the extent to which the thin capitalisation rules would apply to deny a deduction for Sub Co 2's interest expense.

To address this anomaly, an amendment has been made to explicitly identify the top-tier New Zealand company in a chain of companies "controlled" by a single non-resident "by any other means whatsoever" to be the New Zealand Parent in relation to the lower-tier companies.

Thus in the example above, following the amendment to section FG 4(10), Controlled Co will be identified as the New Zealand parent of both Sub Co 1 and Sub Co 2.

Grouping of branches and subsidiaries (Select Committee amendment)

A submission made to Select Committee identified a further deficiency with the New Zealand group rules, concerning the ability to group a foreign company's New Zealand branch operation with its New Zealand subsidiaries.

If a non-resident had a branch operation in New Zealand and also controlled a New Zealand subsidiary, the grouping rules required the branch to include the subsidiary in its New Zealand group. However, they generally excluded the branch from the New Zealand group of the subsidiary (section FG 4(14D) could have been applied to group the subsidiary with the branch, but in limited circumstances).

This result was not intended. The purpose of the grouping rules was to ensure that groups for thin capitalisation purposes are determined consistently. In other words, if Company A's New Zealand group includes Company B, Company B's New Zealand group should include Company A. This prevents companies from manipulating the thin capitalisation rules through their choice of grouping arrangements.

An amendment has, therefore, been made to section FG 4(10), so that when a non-resident has both a branch and a subsidiary in New Zealand, only the branch will now be determined to be a New Zealand parent.

On-lending concession

The on-lending concession in section FG 6 previously did not apply to funds on-lent by a taxpayer to an associated person resident in New Zealand. This created

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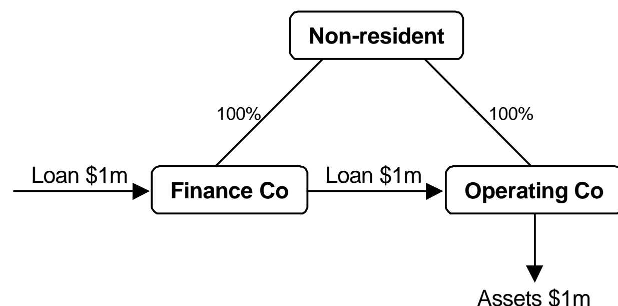
an anomaly if the associated person was also subject to the thin capitalisation rules but was not a member of the taxpayer's New Zealand group. It was then possible that the same amount of debt could be subject to the thin capitalisation rules in the hands of two separate taxpayers, with a potential double denial of interest expense.

This effect is illustrated by the following example. Finance Co and Operating Co are both 100% owned by the same non-resident shareholder. Under the thin capitalisation rules, the two companies can form separate New Zealand groups.



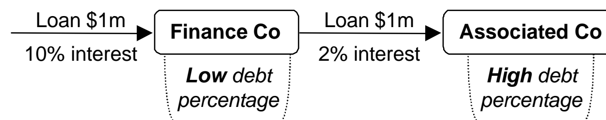
Assuming the equity in each of the companies to be negligible, Finance Co would have been treated as having debt of $1m and assets of $1m (the loan to Operating Co). Operating Co would similarly have been treated as having debt of $1m and assets of $1m.

When viewed as a whole, however, the two companies have consolidated debt of only $1m and consolidated assets of $1m. By not allowing the on-lending concession to apply for Finance Co, the thin capitalisation rules previously created the potential for a deduction to be denied twice on what was, in essence, a single amount of debt.

An amendment has, therefore, been made to section FG 6 to permit the on-lending concession to apply in the above situation.

Requirement for arm's length consideration

The amendment also introduced a requirement that funds be on-lent for an arm's length consideration if they are to qualify for the section FG 6 on-lending concession. This requirement was introduced to counter situations such as the following:



If an arm's length requirement did not exist, Finance Co, as the only company in its New Zealand group, could be structured to utilise the on-lending concession to generate a low debt percentage while having a large interest deduction (the 8% net interest paid on the $1m loan). Associated Co, also as the only company in its New Zealand group, may then have been subject to a denial of a deduction for interest expense under section FG 8, but the amount denied would be far lower than if Finance Co and Associated Co performed consolidated calculations (the effect of the artificially low 2% interest rate).

Introducing the requirement that on-lending be at an arm's length consideration prevents the section FG 6 on-lending concession from being used to circumvent the intended effect of the thin capitalisation rules.

Interest expense brought within ambit of rules

The thin capitalisation rules previously applied only to interest expense allowed as a deduction under the general interest deductibility rules in section DD 1(b) and, by extension under section FG 9, to specified leases.

The thin capitalisation rules were intended to focus on the amount of debt in New Zealand on which an interest deduction is allowed. In principle, therefore, interest deductible other than under the general interest deductibility rules in section DD 1(b) should also be included within the ambit of the thin capitalisation rules. Its omission was not intended when the thin capitalisation rules were enacted.

An amendment has therefore been made to include the following debt and interest expense within the ambit of the rules:

- funds borrowed to purchase shares in amalgamating companies
- deductions of building societies
- money borrowed and applied as capital in a forestry business.

Group investment fund distributions to super funds

Section HE 2(3) and OB 1, Income Tax Act 1994

Introduction

Distributions from group investment funds to superannuation funds will be treated as if they were distributions from companies from 1 April 1999.

At present, distributions from group investment funds to superannuation funds are treated as distributions from qualifying trusts.

Background

Group investment funds (GIFs) were originally established so that trustee companies that managed many, often small, trusts and estates could manage them more effectively by pooling those investments in a manner similar to the Common Fund of the Public Trustee.

GIFs involved in commercial activities are collective investment vehicles that are similar to unit trusts,

although they are subject to separate tax rules. GIFs are taxed under a dual regime, with distributions of earnings from their trustee activities taxed under rules applying to other trustees, and distributions of earnings from their commercial activities taxed under the rules applying to companies and unit trusts.

The income of a GIF that is generated from investment by a superannuation fund is currently subject to trust taxation because superannuation funds are "designated sources" for the purposes of the GIF rules in section HE 2(3) of the Income Tax Act 1994. This means all distributions from GIFs (except beneficiary income) to the investors that are superannuation funds are exempt from tax.

Superannuation funds holding investments on revenue account can effectively convert revenue account holdings to capital holdings by investing in "passive" group investment funds. Passive or indexed funds are funds that match a market index. These funds are not taxable on gains made on the disposition of investments, as they are not in the business of dealing in shares. The tax advantage superannuation funds are gaining by investing in passive GIFs is not what the tax exemption for investments in group investment funds by designated sources was intended for.

It is arguable that removing superannuation funds from designated sources should have occurred along with the 1989 changes to superannuation taxation. With the advent of the "taxed, taxed, exempt" system, the potential for double taxation, which was a major policy reason behind the inclusion of superannuation funds in designated sources, was eliminated. Under the "taxed, taxed, exempt" system, contributions to superannuation funds are made out of taxed income and there is no deduction for such contributions. The earnings of superannuation funds are taxed and all distributions from superannuation funds, whether lump sums or pensions, are exempt.

Key features

Superannuation funds have been removed from the "designated sources" of a group investment fund in section HE 2(3). The effect is that investment by superannuation funds will be treated the same as all other investments in a group investment fund that are subject to company taxation:

- Distributions will be treated as dividends. The share repurchase rules will apply to determine the portion of the distribution that is capital, and therefore excluded from the definition of dividends. Any imputation credits attached to income distributed will prevent double taxation.
- Group investment funds that are not listed are currently included within the definition of unlisted trusts, so will have access to both the slice rule and the ordering rule for determining whether part of the distribution is from capital. Listed group investment funds will have access to the ordering rule only.
- Transitional rules will provide that group investment funds may elect to apply the slice rule to interests of a superannuation fund as at 1 April 1999.
- The available subscribed capital in respect of the superannuation fund's "shares" in the group investment fund from 1 April 1999 will be the value of the superannuation fund's interest in the group investment fund at the close of business on 31 March 1999.

Application date

The amendments apply from 1 April 1999.

Tax-free allowances and shareholder-employees

Section OB 1, Income Tax Act 1994

An amendment has been made to remove an anomaly that prevents certain shareholder-employees from receiving tax-free allowances.

In certain circumstances, income derived by employees from companies in which they are also shareholders is deemed to be derived other than by way of source deduction payments. The circumstances in which this occurs are listed in section OB 2(2), and are generally limited to income which is not derived by way of regular payments throughout the income year. The legislation is intended to prevent the deferral of income tax revenue, by providing that the income is subject to provisional tax, rather than PAYE.

The term "employee" is defined in section OB 1 as "a person who receives or is entitled to receive a source deduction payment". As a result, shareholder-employees who fall within section OB 2(2) are not employees for the purposes of the income tax legislation. This means that they are unable to receive tax-free allowances, while the Act also prevents them from claiming deductions for employment related expenditure.

The amendment corrects this anomaly by extending section OB 1's definition of "employee" to include, for the purposes of section CB 12 (the section governing allowances), shareholder-employees who fall within section OB 2(2). This amendment applies from 1 April 1999.

PAYE tax treatment for office holders

Sections OB 1 and OB 2, Income Tax Act 1994

Amendments have been made to confirm PAYE tax treatment for members of Parliament and judges. In practice they are already subject to PAYE tax treatment; the amendments codify this existing practice.

The original amendments also extended to the tax treatment of elected members of local authorities, but this was dropped from the legislation at the request of the select committee that considered the bill. The committee had received submissions advising that the amendments would disadvantage elected members, on the basis that they would no longer be able to claim deductions for work-related expenditure.

Section OB 2's definition of "source deduction payment" has been extended to include a payment made to a specified office holder in respect of the activities of a specified office.

A definition of "specified office holder" has been inserted in section OB 1. This definition includes a Member of Parliament or a judge. (It describes a judge as a judicial officer whose salary and principal allowances are determined by the Higher Salaries Commission.) This will mean that these persons will be subject to PAYE tax treatment (while still retaining their status as office holders).

The amendments apply from 1 April 1999.

Forestry rights to oneself – no tax consequences

Section GD 1, Income Tax Act 1994

The Income Tax Act was amended by the Taxation (Remedial Provisions) Act 1998 to ensure that no tax consequences resulted from the creation of forestry rights to oneself under the Forestry Rights Registration Act 1983. However, section GD 1, which provides that if a forestry right is sold, created or granted for inadequate consideration, the market value of the right should be treated as gross income, was overlooked. This omission undermined the intention that no tax consequences should arise. Section GD 1 has now been amended to ensure that such tax consequences do not arise.

The amendment applies to rights to take timber created or granted from the start of the 1997-98 income year.

Low income rebate if in NZ for only part of year

Section KC 1(2), Income Tax Act 1994

For the purposes of calculating the low income rebate, the income of taxpayers who reside in New Zealand for only part of the income year is grossed up to an annual amount. This ensures that individuals on high incomes do not qualify for the rebate.

Before the amendment, section KC 1 did not provide for the rebate to be reduced relative to the number of days spent in New Zealand, and this meant that the rebate was overstated in some cases. The section has been amended to provide that the rebate calculated as a result of grossing up the income is reduced, relative to the number of days spent in New Zealand.

The amendment applies from the start of the 1999-2000 income year.

Stamp duty refunds must be requested within 8 years

Section 68, Stamp and Cheque Duties Act 1971

Section 68(1), which was repealed in error when the legislation implementing the new taxpayer compliance, penalties and disputes resolution rules was enacted in 1996, has been reinstated. The amendment reinstates the original intent of the legislation, that the Commissioner can refund overpaid stamp duty only if a written application is made within eight years of the overpayment.

The amendment applies to every transaction liable to stamp duty entered into on or after 1 April 1997.

ACC premiums – small balance write-offs

Section 132, Accident Rehabilitation and Compensation Insurance Act 1992

Section 2 of the Accident Rehabilitation and Compensation Insurance Amendment Act 1998 amends section 132 to increase the small balance write-off for ACC premiums from $5 to $20. This means amounts of $20 or less owing by persons under the Accident Rehabilitation and Compensation Insurance Act can be written off.

The amendment ensures that the threshold for small balance write-offs for ACC premiums is the same as for the income tax rules. It applies from 1 April 1999.

Trading stock tax reform

Introduction

A new subpart EE in the Income Tax Act 1994 sets out the rules for valuation of trading stock at year end. The amendments aim to improve the coherence of income tax law by codifying the tax rules applying to trading stock, in turn reducing compliance costs.

Background

The tax treatment of trading stock (or inventory) affects all businesses deriving income from manufacturing or producing goods, or trading in goods. Businesses must include in their tax returns the annual change in the value of their trading stock.

Despite the central importance of trading stock in calculating income subject to tax, there had been no major legislative review of trading stock rules since their original enactment in the Land and Income Tax Amendment Act 1939.

The trading stock reforms arise out of a review by the Committee on the Taxation of Income from Capital (the Valabh Committee). This was a consultative committee set up to hear public submissions on matters concerning the design and implementation of certain reforms. The *Final Report* of the committee, including recommendations for trading stock, was released in 1992.

The Government discussion document *Trading Stock Tax Rules* was released in April 1997 to allow consideration to be given to the practical impact that changes to the trading stock rules would have on taxpayers. In particular, the Government was interested in comments on the compliance cost aspects of the proposals. The proposals in the discussion document were generally based on the Valabh Committee's recommendations.

Although broadly consistent with the proposals in the discussion document, the trading stock reforms as enacted have been modified to reduce compliance costs for most taxpayers and are now more closely aligned with financial reporting requirements. The rules are divided into two categories: rules for "small" taxpayers and rules for other taxpayers. During consideration of the bill by the Finance and Expenditure Committee, some changes were recommended.

The select committee recommended that transitional income spreading, available for taxpayers affected by the repeal of the obsolescence provision, be extended to taxpayers who have excepted financial arrangements. The committee also recommended technical and drafting changes to improve the overall quality and clarity of the legislation.

Key features

- The definition of "trading stock" will be clarified so that it is limited to a business undertaking and linked to a purpose of sale in the course of the business.
- Trading stock must be valued using a cost valuation method, or when market selling value is lower than cost, market selling value may be used.
- Cost is determined using "generally accepted accounting principles". The requirements of Financial Reporting Standard No.4 *Accounting for Inventories* (FRS-4) will apply. The value of closing stock calculated under FRS-4 must be materially correct. This value will be adjusted for any variance between actual costs incurred and costs budgeted for.
- Replacement price and discounted selling price are cost valuation methods. They may be used to approximate cost if the methods are used for financial reporting purposes.
- The market selling value is the selling price in the ordinary course of business. Certain direct selling costs may be deducted in calculating market selling value if they have been taken into account for financial reporting purposes.
- There are simplified rules for "small taxpayers", defined as those who, together with associates, have an annual turnover of $3 million or less. For stock valued at cost, small taxpayers must apply the same level of cost absorption to manufactured stock as they previously did under *Public Information Bulletin* No.82, unless they absorb more costs in "financial statements". Small taxpayers may use market selling value for stock which has a value above cost, if they do so consistently from year to year. Replacement price and discounted selling price options are also available.
- Excepted financial arrangements which are held as trading stock must be valued at cost only. Taxpayers must apply a cost-flow method of assigning costs (FIFO or weighted average) to excepted financial arrangements that are trading stock or revenue account property. Excepted financial arrangements which are worthless may be valued at nil. Transfers of excepted financial arrangements within a wholly-owned group of companies, when the market value is less than cost, will be deemed to occur at the transferor's cost.
- Transitional rules allow income spreading, in equal amounts, over the 1998-99 income year and the next two years for income arising from the repeal of the obsolescence provision or from valuation of excepted financial arrangements at cost only.

Application date

The amendments apply from the 1998-99 income year except for the rule that requires members of a wholly-owned group of companies to transfer certain shares at cost, and amendments to the Tax Administration Act. These amendments apply from 26 November 1998, the date the legislation was enacted.

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Application of the new rules

Section EE 1 of the Income Tax Act provides for the application of subpart EE. It applies to the trading stock of a taxpayer that owns or carries on a business.

For taxpayers that hold trading stock for sale or exchange in the ordinary course of their business, the new rules will apply to determine the value of trading stock held at the end of the income year.

Provisional tax for 1998-99 income year

The rules generally apply from the 1998-99 income year. Taxpayers should take into account the new trading stock rules when making payments of provisional tax (as alerted by Inland Revenue in TIB Volume Ten, No.5 (May 1998)). If taxpayers have underpaid their provisional tax, they may make additional payments at any time to reduce their exposure to use of money interest.

Definition of "trading stock"

The definition of "trading stock" has been clarified. It has been amended only as far as it applies to new Part EE (except section EE 19, which re-enacts section EE 2, providing that insurance receipts in respect of trading stock are gross income). The definition of trading stock as it relates to section EE 19 has not been amended.

The definition of trading stock includes livestock, but section EE 4 confirms that the value of livestock not used in dealing operations will be determined under subpart EL and not subpart EE.

The trading stock definition excludes:

- Consumable aids on hand at year end, which are dealt with under the accrual expenditure rules in section EF 1 (subject to Determination E10).
- Spare parts that are not held for sale or exchange in the ordinary course of business. Spare parts held for fulfilling warranty requirements will be trading stock as they are held for exchange. Spare parts held for maintaining plant that are treated as inventory under FRS-4 should either be depreciated (when appropriate) or dealt with under the accrual expenditure rules in section EF 1.

Services continue not to be included in the definition of trading stock. Land continues to be excluded from the definition of trading stock.

FRS-4 specifically includes services, consumables and some spare parts in inventory. These will need to be removed from the FRS-4 value of inventory for tax purposes. However, in practice, to the extent that the accrual expenditure rules apply to consumables and spare parts it is unlikely that any net adjustment will be needed.

Valuation at cost or market selling value if lower than cost

Section EE 2 sets out the mechanism for including in a tax return the annual change in the value of trading stock. The change in the value of trading stock is included in gross income each year by allowing a deduction for the value of opening stock, and bringing into gross income the value of closing stock. Both opening stock and closing stock are defined in section OB 1.

Closing stock must be valued using a cost valuation method, or when market selling value is less than cost, market selling value may be used. Replacement price and discounted selling price may be used to approximate cost if a taxpayer uses these methods in "financial statements". The valuation methods available are set out in section EE 3.

Taxpayers may use one or more valuation methods to value their closing stock. They may use a cost valuation method for some stock and market selling value for other stock that has a value less than cost. Taxpayers may also use more than one cost valuation method to value closing stock. However, it is generally expected that they will apply the same cost valuation method to groups of similar or related items of trading stock. For example, a manufacturer might use cost to value most stock and discounted selling price for stock sold in a factory shop. The cost valuation methods used must be consistent with those adopted for financial reporting purposes.

The valuation options are similar to the requirement in FRS-4 to measure inventories at the lower of cost and net realisable value. However, for tax purposes, taxpayers are not required to measure whether trading stock has a market selling value less than cost. If they choose to do so, they may value all stock at cost. If stock is valued at net realisable value for financial reporting purposes, taxpayers may use market selling value if the stock has a value less than cost, or a cost valuation method.

Figure 1 sets out an outline of the process to be followed by taxpayers other than small taxpayers in applying the rules for valuation of trading stock for tax purposes. The steps are set out in summarised form. A more detailed explanation of each step in the process follows. Later, there is an explanation and flow chart showing the application of the valuation rules for small taxpayers.

Determining cost using "generally accepted accounting principles"

Those taxpayers other than small taxpayers valuing stock at cost must include all costs required by "generally accepted accounting principles", as defined. The rationale is that taxpayers will not have to incur the compliance costs of preparing separate tax valuations. The Financial Reporting Act 1993 requires issuers of securities to the public and all companies (other than

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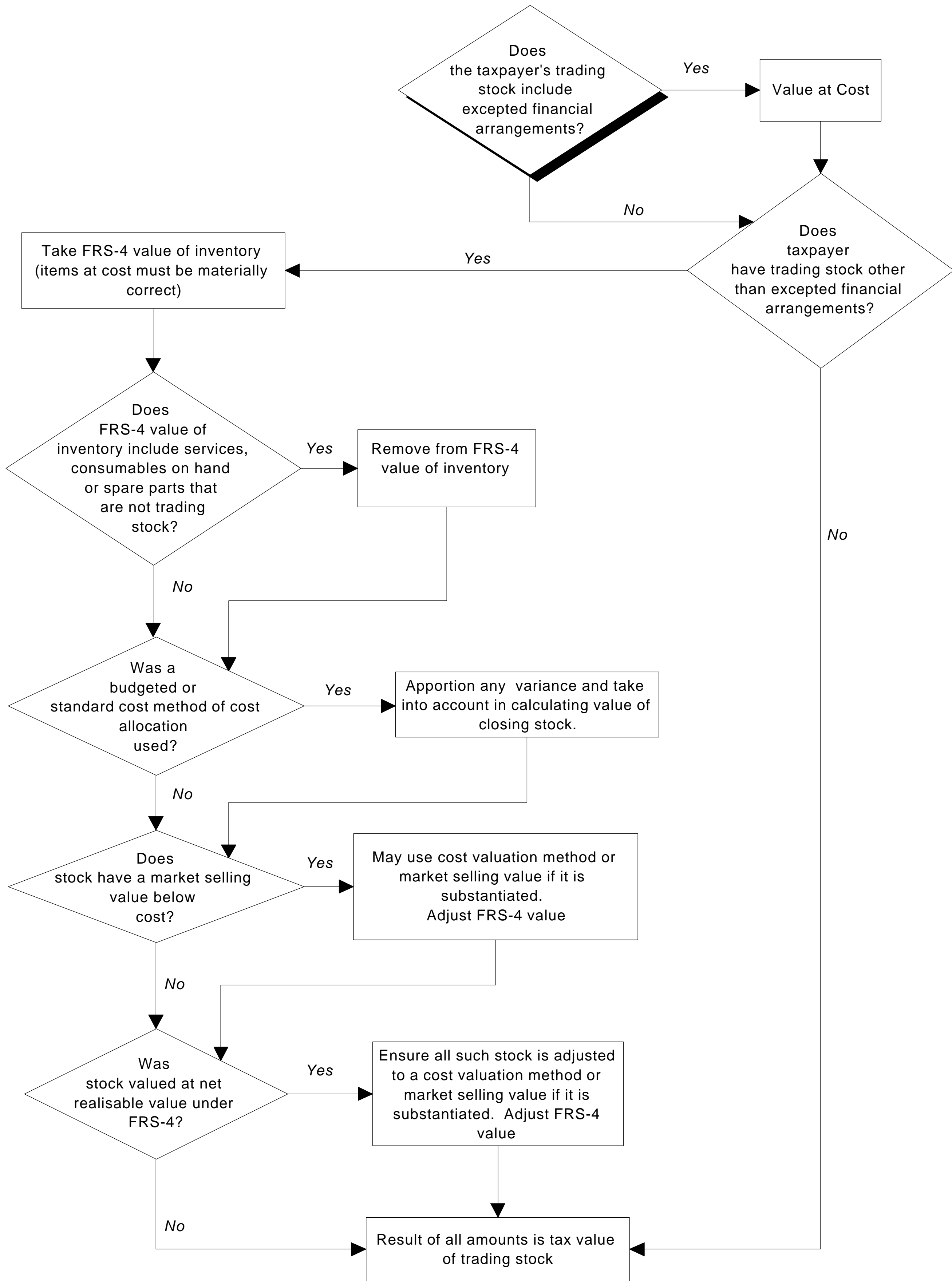
Figure 1: Outline of valuation process for taxpayers other than small taxpayers



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exempt companies, as defined) to file "financial statements" that comply with generally accepted accounting practice. Other entities may also be required to prepare financial reports in accordance with "generally accepted accounting principles".

The reference in the definition of "generally accepted accounting principles" in section OB 1 to "generally accepted accounting practice" means applying FRS-4 and the general principles from the *Statement of Concepts for General Purpose Financial Reporting*. Materiality is one of these general principles. The meaning of "generally accepted accounting practice" is described in the *Explanatory Foreword to General Purpose Financial Reporting*. In simple terms, taxpayers are required to comply with FRS-4 when valuing trading stock at cost. For taxpayers required to comply with "generally accepted accounting principles" for tax purposes, this TIB item should be read together with FRS-4, the *Statement of Concepts for General Purpose Financial Reporting* and the *Explanatory Foreword to General Purpose Financial Reporting*.

The requirements of FRS-4 are applicable to the extent that they apply to trading stock as defined in tax law. The definition of trading stock for tax purposes is different from the definition of inventories in FRS-4. For example, consumable stores and supplies are included in inventory but are excluded from the definition of trading stock for tax purposes.

Materiality

Materiality is a concept which relates to the accuracy of valuation of financial statement items. Materiality is incorporated in valuations of inventory for financial reporting purposes. Because the requirements under "generally accepted accounting principles" are subject to materiality, it is incorporated into the tax law to prevent taxpayers incurring the compliance costs resulting from calculating a perfectly correct amount.

Section EE 5(2) requires taxpayers, other than small taxpayers, to have a materially correct valuation of trading stock under FRS-4. This means taxpayers must consider materiality in the context of trading stock alone, instead of in the context of the financial statements as a whole. The reason for considering materiality for trading stock alone is that if materiality was considered in the context of the financial statements, material errors in the valuation of trading stock could be offset by other errors in the financial statements.

In relation to trading stock valued at cost, the application of materiality means that the valuation need only be materially correct and not perfect. Amounts of costs which are immaterial for financial reporting purposes under FRS-4 and have not been included in the value of inventory under FRS-4 will be immaterial for tax purposes.

The concept of materiality for financial reporting purposes is described in paragraphs 6.5 to 6.8 of the *Statement of Concepts for General Purpose Financial Reporting*. Paragraph 6.5 states:

> A statement, fact or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial reports are completed, is likely to influence the users of financial reports in making decisions or assessments.

Inland Revenue is a user of the part of the financial reports that contains (or "recognises") a valuation of trading stock.

Further guidance on the criteria for establishing materiality may be obtained from Statement of Standard Accounting Practice No.6 *Materiality in "financial statements"* (SSAP-6).

Inclusion of costs under FRS-4

The costs to be included under section EE 5(1) are those of putting trading stock in its present location and condition, which is a requirement of FRS-4. The costs to be included are those which are claimed for financial reporting purposes under FRS-4. Some of these costs, such as depreciation or repairs and maintenance, may be different from the amounts allowed for tax purposes. The accounting values of costs such as depreciation are only relevant for tax purposes for calculating the value of closing stock. For all other purposes, the specific tax provisions in the Income Tax Act governing deductions will apply. For example, depreciation allowances will be calculated in accordance with subpart EG and deductible in accordance with sections BD 2 and BD 4.

FRS-4 states that the cost of inventories includes the costs of purchase and other production costs. Costs that are directly and indirectly related to production must be included in cost. An example given in FRS-4 of directly related costs is labour. Indirectly related costs include fixed and variable production overheads. Examples given of fixed production overheads include depreciation and maintenance of factory buildings and equipment and the cost of factory management and administration. Examples of variable production overheads include indirect materials and indirect labour. For more detail on the exact requirements of FRS-4, the Standard should be referred to at paragraphs 5.5 to 5.9. Consumables consumed in the manufacture of trading stock must be included in the cost, although consumables on hand do not fall within the definition of trading stock.

FRS-4 is not explicit in addressing the dividing line between costs to be included that relate to bringing inventories to their present location and condition and selling expenses. It states, at paragraph 5.12, that selling expenses are to be excluded from the cost of inventories, as are storage costs, unless those costs are necessary in the production process prior to a further production stage. In particular, this may cause an interpretation issue for transport costs incurred once the trading stock is within the control of the taxpayer. However, in practical terms, this aspect of FRS-4 is being interpreted and applied currently. The costs included for financial

reporting purposes will be acceptable for tax purposes, provided the financial reports apply FRS-4. Practice may vary slightly between taxpayers and may change over time as accounting systems improve.

Example 1: Transport costs not included for generally accepted accounting principles

Company K is a furniture retailer. It has a nationwide chain of stores and a central warehouse. For any particular product about 50% of the stock will be delivered direct to the stores, with the balance dispatched to the central warehouse. The product from the warehouse is distributed around the country on a replenishment basis to replace stock in the stores as it is sold. Depending on customer requirements, stock may be moved from one store to another, from the store back to the warehouse for supply to another store, or from the warehouse to a store to fill a particular order. Company K has a fleet of its own trucks for delivery purposes and employs drivers. For financial reporting purposes, Company K does not include these transport costs (for transport to and from the warehouse and stores) in the cost of its inventory. It has never included these costs, and Company K's auditors regard this as compliance with FRS-4. As a practical matter, it would have great difficulty in identifying the costs which related to delivery of the stock, as the trucks are also used for delivery to customers once a sale has been made. For tax purposes, it is acceptable for Company K not to include the transport costs in the cost of its trading stock.

Example 2: Transport costs included for generally accepted accounting principles

Company U is a retailer with many retail outlets nationwide. It has a distribution centre from which all stock orders are co-ordinated. The deliveries are made from the distribution centre to the outlets for sale to the public. The distribution of stock from the distribution centre to the retail outlets is carried out by a firm which is contracted to Company U for this purpose. For financial reporting purposes, Company U includes the costs paid to the independent contractors for delivery of stock to the retail outlets in its cost of inventory. For tax purposes, Company U would also be required to include these transport costs in the cost of trading stock.

Allocation of costs

Taxpayers must allocate costs to closing stock under section EE 5(1), using methods acceptable under "generally accepted accounting principles". FRS-4, at paragraph 5.29(b), requires separate disclosure of the value of each sub-classification of total inventories classified in a manner appropriate to the entity. The commentary to FRS-4 at paragraph 5.30 notes that common sub-classifications include raw materials, work in progress, finished goods and merchandise.

Allocation of variance

Taxpayers who comply with FRS-4 in their financial reports will have to adjust for actual costs if budgets or standard cost systems have been used for financial reporting purposes. This includes both price and volume variances. This approach of adjusting for variances was recommended by the Valabh Committee because tax valuations at cost should reflect the actual costs incurred in the production process.

FRS-4 allows unallocated overheads as a result of low production to be expensed. In addition, variances from standard costs are to be accounted for as revenue or expense when standards have been properly set or maintained. The sum total of all of these variances must be calculated. The figure of the total variance must be apportioned, under sections EE 5(3) and EE 5(3A), between the relative values of the cost of goods sold and closing stock for tax purposes, to work out the proportion of the variance which relates to stock on hand. In simple terms, if closing stock on hand represents 25% of the combined total of stock on hand and sales made during the year, then 25% of the total variance should be allocated to closing stock.

The apportionment can be made to closing stock on a global basis and is not required to be further apportioned to raw materials, work in progress and finished goods or other sub-classifications of trading stock. For operations with multiple activities or products, variances may be allocated according to a fair and reasonable method of apportionment, such as apportioning based on the cost of the stock on hand compared with the cost of goods sold, as demonstrated in Example 4. Other methods of apportionment that are reasonable and appropriate will be acceptable for tax purposes.

The variance for the current year which relates to trading stock on hand must be taken into account in the calculation of closing stock. Taxpayers do not need to take into account the previous year's variance when calculating this year's closing stock. This means the variance allocated to closing stock each year is based on the variances arising from the difference between actual costs and budgeted costs in that year. The variance can be favourable or unfavourable. That is, the taxpayer may have spent less on actual costs than budgeted for (a favourable variance), or more than budgeted (an unfavourable variance).

Example 3 sets out how cost is to be determined using "generally accepted accounting principles" and how the variance between actual costs and budgeted costs is to be allocated. Example 4 indicates how the variance may be allocated when a taxpayer has multiple products and activities. However, it is just an illustration and is not the only method by which an allocation can be made.

Example 3: Valuation of manufactured stock at cost

Company A is a footwear manufacturer. It started operations in the 1998-99 income year. It manufactures many sizes of shoes which it sells for the same price. Accordingly, Company A considers itself to be a single product manufacturer and does not differentiate its costs between different sizes of shoes.

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Company A has incurred the following production expenditure in the 1998-99 income year:

	$
Direct materials	1,650,000
Direct labour	1,810,000
Indirect materials	445,000
Utilities (heat, light and power) incurred in factory	325,000
Indirect factory labour costs	135,000
Factory plant depreciation	205,000
Factory plant repairs and maintenance	80,000
Factory rent	200,000
Consumables used	190,000
	5,040,000

Company A had consumables on hand at year end of $60,000, which were included in inventories for financial reporting purposes.

Company A manufactured 140,000 pairs of shoes during the income year and has 20,000 pairs unsold at balance date. Budgeted production was 160,000 pairs of shoes.

All price variances were fully adjusted for because the budgeted costs had not been revised to reflect the drop in production. Volume variances were not adjusted for as Company A had complied with paragraph 5.7 of FRS-4 by allocating overheads based on normal capacity.

Closing stock for financial reporting purposes was $630,000 (not including consumables on hand).

Calculation of value of closing stock

The calculation of the cost of sales and value of closing stock is as follows:

	Financial Reporting Purposes	**Tax Purposes**
	$	**$**
Absorbed costs (per "financial statements")	5,040,000	5,040,000
Divide by production (units)	160,000	140,000
Gives cost per unit	31.50	36
Closing stock (20,000 x cost per unit)	630,000	720,000

Budget variance

Sections EE 5(3) and EE 5(3A) require Company A to prorate the unfavourable budget variance between the cost of goods sold and the closing stock. The value of the closing stock reflects the actual costs incurred that relate to closing stock. For financial reporting purposes, Company A's closing stock reflects the normal and budgeted level of production and the cost per unit that it had budgeted for.

Consumables

For financial reporting purposes, the $60,000 cost of consumables on hand is included in inventory.

Consumables on hand are not included in the tax definition of trading stock. Therefore Company A is required under section EF 1 to include the $60,000 as gross income and be allowed a deduction for that amount in the 1999-2000 income year.

Note: Even if the level of unexpired portion of the consumable aids was less than the $58,000 threshold stated in Determination E10, the determination does not apply to expenditure if a deduction for the expenditure has been deferred to a subsequent income year for financial reporting purposes. Therefore if the cost of consumables is included in inventory for financial reporting purposes, it must also be included in gross income under section EF 1.

Example 4: Allocation of budget variance across multiple products

Company B manufactures children's toys. During the 1998-99 income year, Company B made three types of toys: X, Y and Z.

Although Company B had budgeted production costs of $2,000,000, the actual costs incurred were $2,400,000. In other words, Company B had an unfavourable budget variance of $400,000. Section EE 5(3) requires Company B to prorate the budget variance between the cost of sales and the goods on hand at balance date. Company B has decided to prorate the variance based on the cost of goods sold compared with the cost of the stock on hand.

	Cost per unit $	Units sold	Units on hand	Cost of goods sold $	Cost of goods on hand $
Product X	7	100,000	35,000	700,000	245,000
Product Y	8	120,000	22,500	960,000	180,000
Product Z	12	70,000	17,500	840,000	210,000
Total				2,500,000	635,000

Cost of goods sold	2,500,000
Cost of closing stock	635,000

$$\text{Allocation proportion} = \frac{635{,}000}{(635{,}000 + 2{,}500{,}000)} = 0.2025$$

Thus 20.25% of the total variance is to be allocated to closing stock. This means that Company B will absorb $81,000 (20.25% x $400,000) of the budget variance into the value of closing stock. The balance of the variance, being $319,000, is attributable to goods sold.

Cost-flow methods of assigning costs

Cost-flow methods of assigning costs must be used under section EE 5(4) for stock that is not separately identifiable or for excepted financial arrangements that are trading stock or revenue account property.

Section EE 6 states the acceptable cost-flow methods for trading stock, which are the first-in first-out (FIFO) method and weighted average cost method. These methods are consistent with financial reporting requirements. FRS-4 also requires the FIFO or weighted average cost methods to be used for items that are

"ordinarily interchangeable". The commentary to the Standard provides guidance on which method is the most appropriate, at paragraph 5.15. It also states, at paragraph 5.14, that specific identification is not appropriate when there are large numbers of items which are ordinarily interchangeable.

Section EE 6(2) requires taxpayers other than small taxpayers to adopt the same cost-flow method as that adopted in "financial statements" for that year. Weighted average cost-flow methods which are acceptable for financial reporting purposes will be acceptable for tax.

For stock that is separately identifiable, taxpayers have the choice of calculating cost by specific identification or using cost-flow methods of assigning costs.

Joint products and by-products

Valuation of joint products and by-products is not expressly referred to in the legislation. Taxpayers should follow the requirements of "generally accepted accounting principles".

For many taxpayers the application of "generally accepted accounting principles" will result in the allocation of costs on the basis of the sales values of the various products, or if sales values are not available or appropriate, on the basis of a physical measure of the various products. For other taxpayers, such as the meat industry, valuation of trading stock using a discounted selling price approach may be appropriate for financial reporting purposes and, therefore, will be accepted for tax purposes. Industry practices may also change over time as accounting systems and procedures become more sophisticated.

Discounted selling price

Discounted selling price is a cost valuation method. When its use is permitted, it may be used in conjunction with other cost valuation methods or with market selling value. It is generally expected that taxpayers will apply the same cost valuation method to groups of similar or related items of trading stock.

Sections EE 8 to EE 10 set out the rules for the use of the discounted selling price method. The discounted selling price method was contemplated for retailers. However, other taxpayers such as the meat industry use a variation of the method, and this is allowed in the new rules if it is used for financial reporting purposes. Taxpayers other than small taxpayers will only be permitted to use the discounted selling price method when they do so for financial reporting purposes, or if they valued stock using net realisable value for financial reporting purposes.

Retailers

Section EE 8 sets out how discounted selling price applies to retailers. The term "retailer" is not defined. "Retailer" carries its ordinary meaning. It will also cover stock sold at retail by manufacturers in, for example, "factory" shops.

Retailers must calculate the discounted selling price of trading stock by totalling the retail selling prices of a category of stock or a department, less the normal gross profit margin for the department. "Department" and "category" have their ordinary meanings and will depend on what is appropriate in the taxpayer's circumstances. The "normal gross profit margin" must be calculated in accordance with FRS-4. When stock has been reduced from a full retail price, a correct application of the commentary to FRS-4 at paragraph 4.8 will involve a compensatory adjustment to the normal gross profit margin so that an approximation of cost results. The degree of approximation depends on the degree of grouping adopted in associating specific stock items with specific margins.

In calculating the normal gross profit margin, the taxpayer must take into account all costs required under sections EE 5 or EE 7. For taxpayers other than small taxpayers, this means all costs required to be included by "generally accepted accounting principles", such as purchase costs and other related costs.

Taxpayers other than retailers

Section EE 10 specifically provides for the use of the discounted selling price method by taxpayers other than retailers. This allows taxpayers that use the method for financial reporting purposes to do so for tax purposes. The discounted selling price of trading stock is the amount equal to the market selling values, less the normal gross profit margin applicable to that stock. The use of market selling values rather than retail selling prices allows taxpayers to take into account selling costs and the guidelines for when stock is sold into different markets.

The normal gross profit margins must be calculated for a category of stock for other taxpayers. "Category" has its ordinary meaning. In the case of the meat industry, a category of stock would be, at a minimum, a species of animal. Therefore gross profit margins will have to be calculated for sheep, beef, venison and so on. All costs required to be taken into account under sections EE 5 or EE 7 must be taken into account in calculating the normal gross profit margin for each category of stock. For taxpayers other than small taxpayers this means all costs required to be included under "generally accepted accounting principles".

Replacement price

Replacement price is a cost valuation method. When its use is permitted, it may be used in conjunction with other cost valuation methods or with market selling value. It is generally expected that taxpayers will apply the same cost valuation method to groups of similar or related items of trading stock.

Section EE 11 sets out the circumstances in which replacement price may be used. Small taxpayers who do not prepare "financial statements" may use it in all cases. It may also be used by small taxpayers who prepare financial statements, as well as by others, if these taxpayers use it for financial reporting purposes. The

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method is expected to have limited application for taxpayers other than small taxpayers, since FRS-4, at paragraph 5.23, provides for its use only for raw materials. Taxpayers valuing stock using net realisable value for financial reporting purposes may use replacement price. For example, if raw materials or other trading stock are obsolescent and this is reflected in the price at which further purchases could be made, replacement price may be an appropriate valuation option.

Replacement price is a proxy for cost. It is the purchase price that a taxpayer would pay on balance date. However, if a purchase price is not available on balance date because, for example, the goods are out of season, the last price paid during the income year may be used. If the last day of the income year is not a day when the taxpayer is open for business, the taxpayer should treat it as a normal trading day when setting the replacement price. It is not justified to use a special value as the replacement price merely because the last day of the income year is a day on which the taxpayer does not trade.

Consistency and record-keeping requirements

In calculating the value of closing stock using a cost valuation method, section EE 16 requires taxpayers other than small taxpayer to comply with Financial Reporting Standard No.1 *Disclosure of Accounting Policies* (FRS-1), which sets out disclosure requirements. FRS-1 states in its commentary that accounting policies adopted by an entity are normally consistent from one period to another, and are to be applied to all items of a similar nature. It provides that the statement of accounting policies must state whether or not the accounting policies used are consistent with those used in previous periods.

If there have been changes in the measurement system, the assumptions, or the accounting policies used, FRS-1 requires full disclosure of the changes. The effect is to create a record-keeping requirement for changes made to accounting policies and procedures for trading stock.

Section 22(1)(c) of the Tax Administration Act requires statements (including quantities and values) of trading stock to be kept, as well as all records of stocktakings. The section has been amended to include additional record-keeping requirements to the effect that taxpayers other than small taxpayers must retain all accounting records relating to the calculation of the value of trading stock.

In relation to valuing trading stock at market selling value, taxpayers are required to have reasonable evidence to substantiate market selling values, as explained in the next section.

Determining market selling value

The market selling value option may be used when the market selling value is less than cost.

Definition of market selling value

Under section EE 12, the starting point for determining the market selling value of finished goods is the gross amount that a taxpayer will normally receive from selling trading stock in the ordinary course of business. Market selling value must generally be determined as at the balance date. If the last day of the income year is not a day when the taxpayer is open for business, the taxpayer should treat it as a normal trading day when determining the market selling value. It is not justified to use a special value merely because the last day of the income year is a day on which the taxpayer does not trade.

Market selling value is exclusive of goods and services tax because of the operation of section ED 4, which states that amounts of gross income are exclusive of goods and services tax.

Market selling value may only be used when it is less than cost. This indicates that goods cannot be sold at normal prices. For example, goods may have been superseded by newer models or styles, or be shop-soiled, damaged or faulty, the end of a line, or secondhand goods taken in exchange as a trade-in.

The meaning of ordinary course of business takes into account taxpayers' business decisions to clear or exit stock lines for a variety of reasons, including seasonal factors and fashion and technology changes. The act of quitting or intending to quit a particular stock line arises as part of the taxpayer's ordinary course of business. The relevant price at which a taxpayer can clear or exit stock is the market selling value. Sales in the ordinary course of business will also include sales in secondary markets, such as sales of goods that have been traded-in.

Therefore sales in the ordinary course of business will include clearance sales when, for example, stock is sold at discount rates. However, the ordinary course of business will not include sales that are not at arm's length or that are not on an open market, such as sales made to employees at cheap rates.

Market selling value must be calculated on an item-by-item basis. If there are multiple items of stock on hand to be valued, the market selling value will be the sum total of the individual items.

Comparison with "net realisable value"

There are differences between the concepts of market selling value for tax purposes and net realisable value for financial reporting purposes. Net realisable value requires an estimate of the future proceeds of sale. Some taxpayers have used formula write-downs on an ageing basis to estimate the future proceeds of sale. Other taxpayers may make subjective estimates about the ultimate saleability or marketability of the stock or value stock so that it does not have a carrying value in excess of amounts expected to be recovered. This will not be acceptable for tax purposes because market selling value is based on the actual selling price of goods in an open

market. Therefore the selling price of goods is the market selling value, and not a value which takes into account when and how many of the goods will be sold.

Stock valued at net realisable value for financial reporting purposes, may be valued:

- using a cost valuation method (including discounted selling price and replacement price); or
- using market selling value if the stock has a value less than cost and the taxpayer can substantiate the value.

Valuation of obsolete and slow moving stock

Stock affected by obsolescence may be valued using market selling value if the offering price is less than cost. Obsolescent stock that is being sold for a price that is less than the original retail price but more than cost must be valued at cost. To allow write-downs below cost for such stock results in the current year's profit being reduced for tax purposes when a loss will only occur if stock is sold below cost.

Only the items of stock that have a market selling value below cost can be valued using the market selling value option. Excess stock on hand must not be valued below cost if the price for which stock would have sold at balance date was more than cost. To do so does not provide an accurate reflection of a taxpayer's income for tax purposes, although it may be appropriate for financial reporting purposes. This will mean that taxpayers holding slow moving stock must value it at cost unless the stock has a market selling price below cost. Taxpayers will not be able to realise any loss from holding excess stocks until either the stock has an objective market selling value below cost, or it is disposed of.

Work in progress

For work in progress, the gross amount that a taxpayer will normally receive from selling the completed goods in the ordinary course of business is reduced by the costs of completing the goods. However, if work in progress is intended to be sold in an uncompleted form, and not processed through to a finished goods stage, a taxpayer may calculate the market selling value of the work in progress in its uncompleted form.

Raw materials

If raw materials are intended to be sold in unprocessed form, they may be valued using the market selling value. Examples of where raw materials might be sold are if a manufacturer holds small quantities of raw materials for sale, or when raw materials become obsolete or excess to requirements and are sold to attempt to recover all or part of the costs.

Substantiation of market selling value

Taxpayers will be required to have reasonable evidence to substantiate market selling values. Evidence includes offering prices of goods and actual sales for a reasonable period before and/or after balance date, but before the tax return is prepared. If stock is seasonal and no sales are expected around balance date, the last offering prices for a reasonable period during the year would be acceptable. However, there may be a range of values for which goods are sold because of price fluctuations if the market is volatile or there are exchange rate variations. In this event, the evidence should be the best estimate of market selling value.

Taxpayers may have difficulty determining and substantiating market selling value in some circumstances. This may arise when there is no open or active market in the good, or when the stock has not sold for some time and the taxpayer has reason to believe the goods will not sell at their current offering prices. If this information is not available, and the taxpayer wants to use market selling value, the taxpayer may substantiate the market selling value by a valuation which is:

- by a qualified person (in some circumstances, a qualified person may be employed by the taxpayer);
- for tax purposes;
- using the definition of market selling value and not a net realisable value concept set out in FRS-4; and
- exclusive of goods and services tax.

A proposed sale of large amounts of stock to be held by tender will not substantiate a market selling value if the selling price is not known. This is because the market selling value must have an objective basis.

A taxpayer that does not have reasonable evidence to substantiate the market selling value of an item of trading stock must value that item using a cost valuation method. A cost valuation method is defined in section OB 1 to mean cost, the discounted selling price method or the replacement price method.

Determining market selling value when goods are sold into different markets

Market selling value means the value that would have been attracted for goods sold in the ordinary course of business. In some instances taxpayers may sell goods to the public at one price (a retail price) and to tradespeople at a reduced or trade price. Alternatively, they may sell goods in both domestic and export markets, or exporters may sell goods to a number of different countries. All of these are different markets. The markets being sold to must be at arm's length, and not closed markets, such as a sale to employees.

The relevant market selling value depends on the individual circumstances of the taxpayer's business. If stock for sale into a particular market can be identified or is committed, it should be valued at the relevant value for that market.

If the stock for sale into a particular market cannot be identified, taxpayers should make a reasonable estimate of the market selling values for their markets using the following guidelines:

- Goods available for sale in any one of several markets should be valued at a weighted average price. The

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weighting should be based on the most appropriate of either the percentage of actual sales or the anticipated sales volume (not taking into account abnormal fluctuations) into each market. The market selling value is the selling price at balance date.

- If stock is predominantly available in one market, taxpayers may value all of the stock using the relevant value in that market.
- For actual or prospective contracts in foreign currency, taxpayers should use the amount committed, or if it is not yet committed, use the spot rate on balance date.

Selling costs

Direct costs of selling stock which have not yet been incurred may be taken into account in calculating market selling value if these expected costs have been taken into account for financial reporting purposes. This a key feature of the net realisable value concept in FRS-4. The direct selling costs are specified in section EE 12(2) as:

- transport and insurance costs;
- sales commissions; and
- discounts to purchasers.

The costs are those commonly deducted for financial reporting purposes, which are readily verifiable, although they are not exactly the same as those listed in the commentary to FRS-4.

The nature of selling costs is that they will not yet have been incurred. Therefore taxpayers taking into account selling costs must make a reasonable estimate of actual costs expected to be borne. Generally, this estimate might be made on the basis of the proportion of selling costs to annual sales for the current year sales (for the type of stock valued at market selling value), adjusted for any abnormal fluctuations, both historical and projected.

Example 5: Calculation of market selling value

Company C manufactures value-added timber furniture products for export markets.

At balance date Company C has a range of completed furniture ready for export. Owing to an oversupply in the world furniture market, Company C has chosen to value a portion of its finished stock on hand at balance date at market selling value for tax purposes, as this is less than cost.

Company C has a number of preferential customers that attract a 5% purchase discount. From current year's sales, 75% of stock sold was to these customers.

Export sale contracts usually sell goods on a c.i.f. (cost, insurance, freight) basis. Company C has appointed a number of overseas agents to negotiate sales on a commission basis (4% of the purchase price) on its behalf. All goods are sold through agents.

Company C is able to substantiate that the market selling value of the portion of its completed furniture on hand at balance date to be valued at market selling value is $1,125,000.

The anticipated costs of selling the completed furniture are (excluding GST):

Transport	$ 55,000	
Insurance	$ 27,500	
Purchase discounts	$ 42,188	(5% discount x 1,125,000 x 75% stock)
Sales commissions	$ 43,312	(1,125,000 less discount 42,188 = 1,082,812 x 4%)
	$168,000	

For tax purposes under section EE 12(2), these anticipated costs of selling the furniture can be deducted from the market selling value. Accordingly, Company C may value its furniture on hand at balance date at $957,000 ($1,125,000 - $168,000).

Valuation rules for small taxpayers

Figure 2 outlines the process to be followed by small taxpayers in applying the rules for valuation of trading stock for tax purposes. The steps are set out in summarised form. A more detailed explanation of each step in the process follows.

Small taxpayers that prepare financial statements should also refer to the earlier discussion relating to other taxpayers. "Financial statements" is a defined term in section OB 1, and has the same meaning as in section 8 of the Financial Reporting Act 1993. The general meaning in section 8 of "financial statements" is a statement of financial position and a statement of financial performance.

All "small taxpayers" may use the rules for small taxpayers, regardless of whether a member of the Institute of Chartered Accountants has prepared "financial statements" for the small taxpayer.

Definition

Small taxpayer rules apply when annual turnover is $3 million or less. This threshold attempts to set a level above which taxpayers should be sophisticated enough to prepare more detailed valuations of their trading stock. In addition, all companies have financial reporting requirements under the Financial Reporting Act.

Turnover is defined in section OB 1.

The threshold for small taxpayers applies to the taxpayer and any associated persons. The select committee recommended that the associated persons test should be used instead of creating a new definition of "subsidiary" in the Income Tax Act. The definition of "small taxpayer" in section OB 1 refers to the taxpayer and any associated persons, within the meaning of section OD 7, needing to have a total turnover of $3,000,000 or less. Broadly, under section OD 7, companies are associated persons if a person or group has voting interests of 50% or more or control by any other means.

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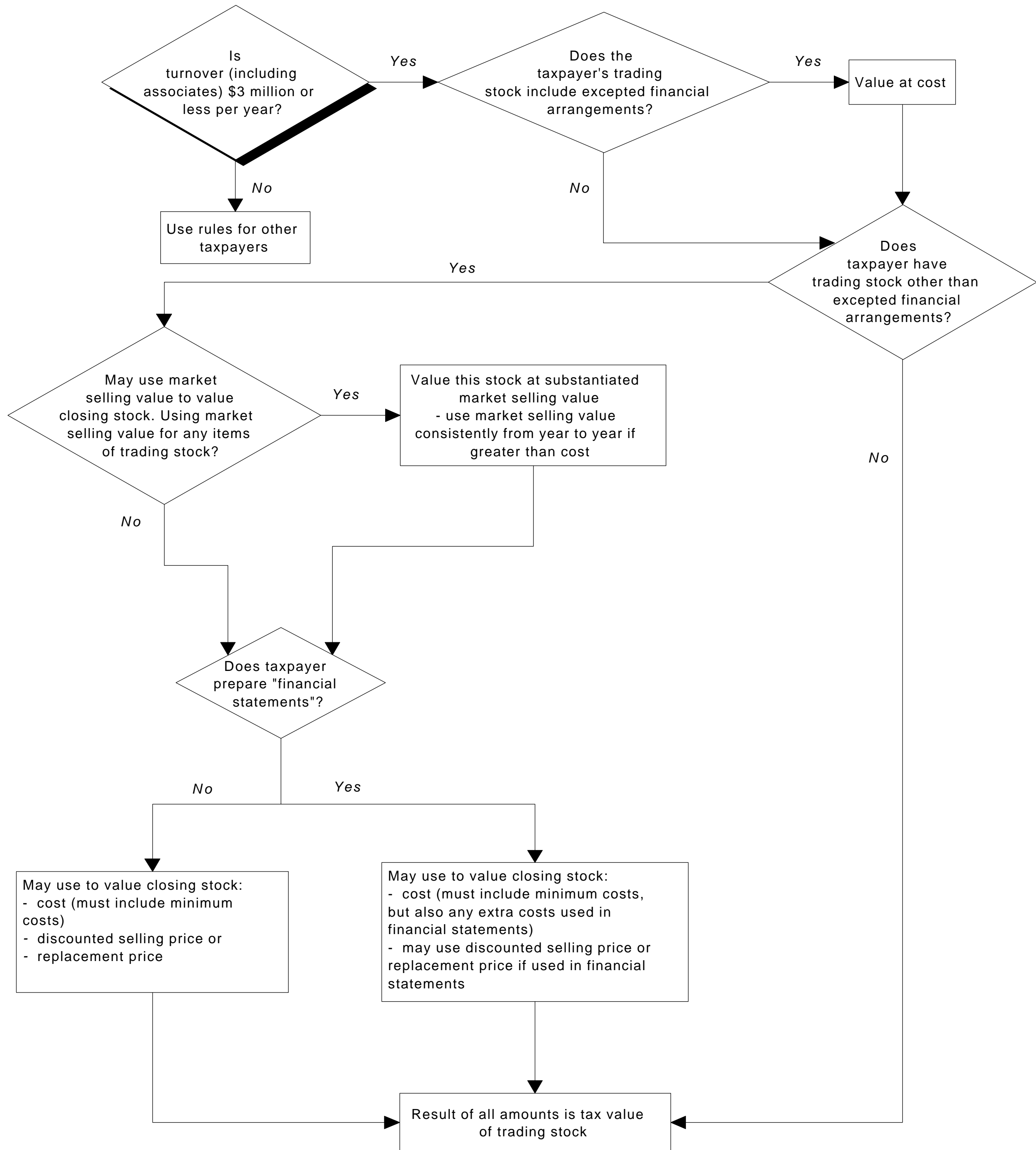
Figure 2: Outline of valuation process for small taxpayers



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Determining cost

Section EE 7 sets out the costs that small taxpayers are required to include in trading stock valued at cost. For manufactured and produced trading stock, taxpayers must include in the costs of production direct and indirect material and labour costs, utilities costs, and the costs relating to factory plant, whether that plant is owned or rented. This is the same level of cost absorption that was required by *Public Information Bulletin* No.82.

Small taxpayers are allowed to include a lesser level of costs than other taxpayers because of the compliance costs of requiring a higher level of cost absorption. The materiality requirements in section EE 5(2) do not apply to small taxpayers.

Small taxpayers that include additional costs of production in "financial statements" need include those additional costs for tax purposes only in years in which accounts are prepared in accordance with FRS-4. For example, if a taxpayer prepares a statement of financial position and a statement of financial performance for a one-off purpose, such as a bank funding application, and includes additional costs of production, the taxpayer will be required to include the additional costs for tax purposes, but only in the year in which such "financial statements" are prepared.

For stock acquired for resale, taxpayers will be required to include in cost, the purchase price, transport and insurance costs. The only insurance costs required to be included are those which relate to bringing the trading stock to the taxpayer, that is, bringing it to its present location and condition. Small taxpayers should include any customs duty in purchasing cost.

Small taxpayers may allocate all costs to closing stock valued at cost, on a global basis. They are not required to allocate costs to sub-classifications of trading stock, such as finished goods, work in progress and raw materials. This approach simplifies cost allocation for small taxpayers and is consistent with the *Framework for Differential Reporting* for financial reporting.

Discounted selling price

Small taxpayers that prepare "financial statements" may use discounted selling price only if they use it in their "financial statements". All other small taxpayers may use discounted selling price.

Some small taxpayers will be able to apply a single gross profit margin to all stock on hand at the end of the income year under section EE 9. The gross profit margin will be the overall margin for the business. This method will apply only to retailers with a turnover of less than $1 million.

All other small taxpayers (other than retailers with a turnover not more than $1 million) will use the same methods as other taxpayers for application of discounted selling price, and these rules should be referred to. The only additional requirement is to apply gross profit margins to different departments or categories of trading stock rather than applying an average gross profit margin to all trading stock. All costs required to be included under section EE 7 must be included when calculating the normal gross profit margin, under section EE 8(5).

Replacement price

Small taxpayers that prepare "financial statements" may use replacement price only if they use it in their "financial statements". All other small taxpayers may use replacement price.

Replacement price is the price that a taxpayer would pay to replace an item of trading stock. Small taxpayers may use the last price paid during the income year for an item of trading stock as the replacement price, under section EE 11(4).

Market selling value

Small taxpayers may use the market selling value option for trading stock that has a value in excess of cost, under section EE 3(2). The rationale is to provide an alternative to a cost valuation when this may be difficult to calculate. In particular, this appears to be a difficult issue for farmers valuing cash crops. If small taxpayers choose to use the market selling value option in these circumstances, they must do so consistently from year to year, under section EE 16(3)(e).

Small taxpayers may also use market selling value for stock that will be sold below its cost, if they can substantiate the value used with reasonable evidence. Reasonable evidence for small taxpayers will include a documented best assessment of market selling value. In the assessment, the small taxpayer would be required to document the valuation and state the factors considered in arriving at market selling value, including any recent sales and current offering prices.

For small taxpayers valuing raw materials or work in progress at market selling value, selling goods into different markets, or wishing to take into account selling costs, see the earlier discussion in relation to other taxpayers.

Consistency requirements

Small taxpayers who comply with "generally accepted accounting principles" must comply with the disclosure requirements of FRS-1, under section EE 16(2).

Other small taxpayers must be consistent from year to year in the five matters described in section EE 16(3):

- the extent to which indirect production costs are included in the cost of manufactured or produced trading stock;
- the cost-flow method of assigning costs;
- the cost valuation method chosen;
- the method of calculating discounted selling price; and
- the use of market selling value when it is above cost.

Small taxpayers may change their method of calculating the value of closing stock if there are sound commercial reasons for the variation. Tax benefits are not considered to be a sound commercial reason.

Matters that would constitute a valid commercial reason would include changes in effective ownership control if the new owners apply different valuation methodologies.

Record-keeping requirements

Small taxpayers must retain records of valuation methods and their application for calculating the value of trading stock under section 22(1)(c)(iv) and (v) of the Tax Administration Act. To avoid unnecessary compliance costs, if taxpayers use the same methods from year to year, they will not have to keep records of valuation methods and their application. However, if they change valuation methods or apply them differently, they must record the change and the reasons for it. Following the recommendation of the select committee, to save compliance costs, taxpayers no longer need to notify the Commissioner of the changes.

Valuation of excepted financial arrangements

Taxpayers must value all excepted financial arrangements that are trading stock at cost. This is the same as the treatment of excepted financial arrangements that are revenue account property.

The primary category of excepted financial arrangements is shares (or equities). However, the rules apply to all excepted financial arrangements, including options and short-term trade credits.

Taxpayers must use cost-flow methods of assigning costs, either FIFO or a weighted average method, to excepted financial arrangements that are trading stock or revenue account property. Specific identification may not be used. The requirement to use cost-flow methods is stated in section EE 13(2) and in an amendment to section EF 2(1).

The application of a cost-flow method to shares will apply only to a type of share, for example, all ordinary shares held in Company D. Cost-flow methods will not apply across a portfolio of shares, as a whole.

Worthless excepted financial arrangements

Taxpayers will be able to write down the value of their worthless excepted financial arrangements that are trading stock.

Section EE 13(3) provides two tests which must be satisfied before a taxpayer can value at nil. The excepted financial arrangement must have no current or likely future market value. Also, it must have been written off as worthless by the taxpayer.

"No current or likely future market value"

Companies that are placed in liquidation, under statutory management or that are delisted from the stock exchange may have shares with no current or likely future market value.

A company that is "unable to pay its debts", which is one basis on which a court may appoint a liquidator under the Companies Act 1993, is likely to have worthless shares if it cannot pay creditors and is placed in liquidation. However, if a company goes into voluntary liquidation, or is placed into liquidation for breaches of the Companies Act, it is possible that there may be some residual value on the shares, which means the shares would not satisfy the test of being worthless. In addition, companies may be delisted from the Stock Exchange and still retain value in their shares. The Exchange has a comprehensive set of listing rules which it requires listed companies to observe. Some of the rules may not have any impact on the value of the shares; for example, there are minimum ownership requirements. However, in other cases it will be clear that a company that is delisted from the Stock Exchange has no value in its shares.

Worthless excepted financial arrangements must be written off

To be valued at nil, the worthless excepted financial arrangement must have been written off.

Transfers within a wholly-owned group of companies

Transfers of excepted financial arrangements that are trading stock or revenue account property between members of a wholly-owned group of companies will be at cost if the market value of the excepted financial arrangement is less than cost.

Excepted financial arrangements that are trading stock or revenue account property that have been transferred within a wholly-owned group of companies at cost, under section EE 14(2), will be deemed to be sold and repurchased at market value when the company holding the excepted financial arrangements ceases to be a member of that group. This rule in section EE 14(3) is stated in similar terms to the rule for trading stock transferred within a wholly-owed group when a member company ceases to be a member of that group (the previous section EE 1(6), which is now section EE 15(2)).

Under section EE 14(4), the dividend rules will not apply to transfers of excepted financial arrangements that are trading stock or revenue account property between members of a wholly-owned group of companies.

Transitional rules for income spreading

The repeal of section EE 1(7), which provided obsolescence rules, means that taxpayers who have used formulas to write down stock under that provision will be required to value stock at cost, unless they can substantiate a lower market value. In addition, the cost-only rule for valuation of excepted financial arrangements will affect taxpayers who have valued shares at market value when the shares had a value below cost in previous years.

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Both of these changes may result in an increase in income for the 1998-99 income year for some taxpayers. Transitional spreading rules will allow taxpayers to spread any income arising from the repeal of section EE 1(7), or the revaluation of excepted financial arrangements, over a three-year period. Spreading will be available in equal amounts for the 1998-99 income year and the two succeeding income years.

In relation to the repeal of section EE 1(7), the only taxpayers that will be entitled to spread income are those which have been given specific written approval by the Commissioner for the write-down of stock under section EE 1(7) or those qualifying under the published formulas in *Public Information Bulletin* No.82, which applied until the enactment of this legislation.

Other changes

Binding rulings

The binding rulings legislation in the Tax Administration Act has been amended so that the Commissioner cannot rule on a matter if that would involve forming an opinion as to "generally accepted accounting principles" or "commercially acceptable practices". This is not an appropriate area for rulings, for the same reasons that questions of fact are excluded from the rulings legislation.

The effect of this amendment is that the Commissioner will not be able to rule on whether trading stock valuation methods adopted by a taxpayer are in accordance with "generally accepted accounting principles".

Consequential amendments

Consequential amendments have been made to the amalgamation rules in sections FE 2 and FE 6 and to the family support rules in section KD 1.

Section FE 2 now requires shares held by a shareholder amalgamating company that are cancelled on amalgamation to be deemed to have been disposed of at cost.

Section FE 6(2) now requires the transfer of trading stock to an amalgamated company to be at the value of the trading stock to the amalgamating company.

Section KD 1(1) states that "trading stock revaluation income" allocated to an income year is not included in determining net income for family tax credits.

Provisions previously in Subpart EE

The previous subsections of section EE:

- EE 1(4) – valuation of livestock;
- EE 1(5) and (6) – transfers of trading stock within a wholly-owned group; and
- EE 1(10) – disposals of trading stock as part of a business

have been retained in Subpart EE as sections EE 4, EE 15 and EE 18, respectively, without substantive amendment.

The previous section EE 2, which deals with the treatment of insurance receipts in respect of trading stock, has also been retained in Subpart EE as section EE 19, without substantive amendment.

Other trading stock provisions in the Income Tax Act

There is no substantive change to the rules for valuation of livestock in subpart EL, nor to other provisions in the Act which deal with trading stock, such as:

- sections FB 3 and FB 4 – disposal of trading stock with other assets of a business;
- section FF 13 – trading stock transferred under a matrimonial agreement; and
- sections GD 1 and GD 2 – transfers of trading stock for inadequate consideration.

Taxation of property obtained without colour of right

Sections CD 6, DJ 18, EN 5, OB 1, Income Tax Act 1994

Introduction

Property obtained without "colour of right" has been included within the meaning of "gross income". A deduction may be claimed for reparation or restitution to the legal or beneficial owner of the property.

A colour of right is an honest belief that the holder is entitled to possession or control of the property. Property obtained by fraud, embezzlement, theft or misappropriation is procured without colour of right.

Background

For many years Inland Revenue's practice has been to tax recipients of misappropriated property on the basis that such property was income. In 1997 the Court of Appeal, in *A Taxpayer* v *CIR,* CA 196/96, held that stolen money was not income according to ordinary concepts. The Court considered that unless stolen money was made subject to income tax by express provision, it was not taxable. The Government's express view is that money obtained without colour of right should be taxable.

Key features

Four specific amendments have been made:

- New section CD 6 provides that property obtained without colour of right will be included within the meaning of gross income and be subject to income tax.
- New section DJ 18 allows taxpayers a deduction for reparation or restitution made to the legal or beneficial owner of the property. The deduction is allowed because if reparation or restitution is made there is no enduring benefit to the taxpayer. Interest payments and other penalties are not deductible.
- New section EN 5 provides that income under section CD 6 is included as income to the taxpayer in the year in which the property was obtained.
- The definition of "property" in section OB 1 has been amended to include money and money's worth for the purposes of section CD 6 and DJ 18.

Similar changes have been made to the Income Tax Act 1976 (see new section 80A and changes to section 2).

Application date

The new rules apply to property taken or controlled since 1 April 1989. The changes in the Income Tax act 1994 apply to property taken or controlled in the 1995-96 and subsequent income years. The equivalent amendments to the Income Tax Act 1976 apply to property taken or controlled between 1 April 1989 and the beginning of the 1995-96 income year. The amendments do not apply to taxpayers who have made competent objections or challenges before 6 March 1998.

Excess imputation credit conversion rate

Section LB 2(3)(iv), Income Tax Act 1976

The conversion rate for excess imputation credits for persons (other than companies, group investment funds and trustees) has been reduced to 21% for the 1999-2000 and subsequent income years.

Excess imputation credits are imputation credits which taxpayers cannot credit against their income tax because they have insufficient income tax liability. These credits are converted to losses to prevent them being refunded to taxpayers. The conversion rate for persons (other than companies, investment funds and trustees) holding excess credits is based on the extra emolument rate, which is the middle effective tax rate.

The conversion rate in section LB 2(3)(iv) has been reduced from 21.75% to 21%. This rate applies from the 1999-00 income year onwards.

Foreign investor tax credit rules – section LE 3 holding companies

Section LE 2(2A),(3), Income Tax Act 1994

Introduction

The rules for determining how a section LE 3 holding company should apply a foreign investor tax credit (FITC) have been amended. Formerly, the FITC had to be applied as far as possible in the income year for which the credit arose. The credit must now be offset in the year for which it arises only to the extent that supplementary dividends have been derived by the company in that year. Any excess credit will be available for offset under the carry-back and group offset rules in section LE 2(4) or the carry-forward rules of section LE 2(5).

Background

The amendment was introduced at the recommendation of the Finance and Expenditure Committee, in response to submissions on the bill.

When a company pays a dividend and a supplementary dividend to a non-resident shareholder, it is entitled to offset a FITC equal to the amount of supplementary dividend paid against its income tax liability.

Special rules exist for holding companies. They address the concern that if a company's only income is from fully imputed dividends, applying the FITC will not give rise to a refund of tax. Instead, excess imputation credits would arise and be converted to a loss to carry forward. Under the special rules, a company can elect to be a section LE 3 holding company. It will then receive dividends and supplementary dividends (instead of fully imputed dividends) as if it were a non-resident. In this way, a tax liability is created against which the foreign investor tax credit can usefully be applied when the company on-pays the supplementary dividend.

However, it was found that the rules did not apply as intended if a section LE 3 holding company did not on-pay supplementary dividends it received in the income year in which they were received. This is because the rules required the company to apply the FITC in the year in which it arose, even though the tax liability against which it was intended the FITC be applied was in an earlier income year. This effect is illustrated in the example overleaf.

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Key features

When a section LE 3 holding company pays a supplementary dividend during an income year, it will be required to offset the resulting foreign investor tax credit against its income tax liability for that income year only to the extent that it has received supplementary dividends in that year.

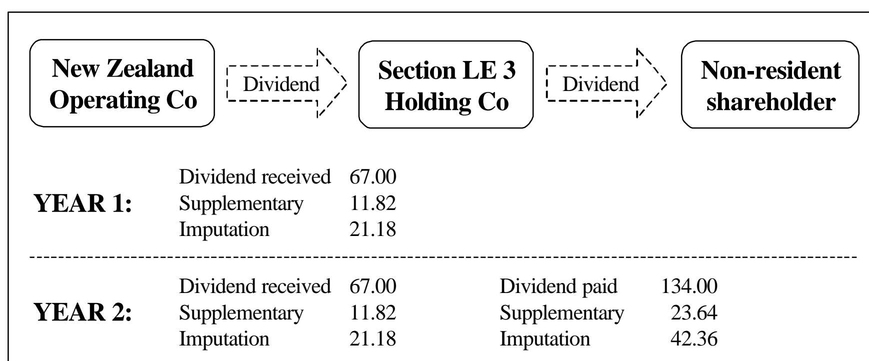
Any excess credit will be able to be applied against tax payable by a group member or by the company in one of the four previous income years (section LE 2(4)), or be carried forward (section LE 2(5)).

Applying the amendment to the example above would mean that Section LE 3 Holding Co would be able to apply $11.82 of the $23.64 FITC against the tax already paid for year 1, thereby receiving an $11.82 refund of tax from that year. Further, because all of the imputation credits received in year 2 are now credited against its year 2 income tax liability, the company will no longer have any loss to carry forward to year 3.

Application date

The amendment applies to the 1997-98 and subsequent income years.

Example – former application of FITC rules to section LE 3 holding companies



In year 1, Section LE 3 Holding Co would have income tax to pay of $11.82 ($100 x 33% – $21.18).

In year 2, Section LE 3 Holding Co's income tax liability would be calculated as:

Cash dividend	67.00
Supplementary dividend	11.82
Imputation credit	21.18
Taxable income	100.00
Tax payable @ 33%	33.00
FITC	(23.64)
Imputation credits	(21.18)
Excess imputation credits	(11.82)
Converted to loss to c/fwd @ 33%	35.82

Consolidated groups excluded from section LE 3 holding company rules

Section LE 3, Income Tax Act 1994

Introduction

Consolidated groups have been excluded from the section LE 3 holding company rules. A consequential amendment has also been made to section LE 3 to ensure that it is consistent with the Core Provisions in Part B.

Background

The effect of the foreign investor tax credit (FITC) rules is to ensure that the maximum rate of New Zealand tax (combining company tax and non-resident withholding tax) on non-resident shareholders in New Zealand companies does not exceed 33%, the same rate as for New Zealand shareholders.

The FITC rules allow a company an income tax credit (the FITC credit) when it pays a supplementary dividend of the same amount to its non-resident shareholders.

A special holding company mechanism in section LE 3 allows the FITC rules to be used in circumstances when a New Zealand holding company has an insufficient tax liability to utilise the FITC credit arising from paying a supplementary dividend to its non-resident shareholders. The mechanism allows a lower tier New Zealand company receiving a dividend and a supplementary dividend (a "section LE 3 holding company") to claim a FITC credit when paying dividends up the chain of companies to the ultimate New Zealand resident holding company with non-resident shareholders.

Key features

Section LE 3(2) has been amended to explicitly exclude consolidated groups from the section LE 3 holding company rules. This is because a consolidated group is generally treated as a single company for tax purposes, so it has no need to use these rules to ensure that it can utilise the FITC credit arising from the payment of a supplementary dividend to its non-resident shareholders. The section LE 3 holding company rules were introduced primarily to allow non-wholly owned groups to utilise the FITC mechanism.

The amendment to explicitly exclude consolidated groups from the section LE 3 holding company rules is retrospective to when the rules came into force, in December 1995. This is because section LE 3(3)(e) indirectly already has that effect. This provision treats a section LE 3 holding company notice as revoked if dividends derived by the former section LE 3 holding company are taxable only under section CB 10. This would apply to dividends derived by a member of a consolidated group from another member of that group as such dividends are exempt from tax under existing section HB 2(1)(a). However, the exclusion of consolidated groups from the section LE 3 holding company rules should be stated explicitly, rather than indirectly provided for through the deemed revocation of a section LE 3 holding company notice under section LE 3(3). The amendment achieves this explicit exclusion.

A consequential amendment has also been made to section LE 3(3)(e) to replace the reference to "exempt income" with "not gross income". The reference to "exempt income" was inserted by the Taxation (Core Provisions) Act 1996. However, this reference was not consistent with the Core Provisions in Part B, which refer in section BD 1(2)(a) to exempt income arising only under Parts C, D, or F (not Part H). The correct terminology in section LE 3(3)(e) is "not gross income" because this would be consistent with section BD 1(2)(b). That section includes as an amount that is not gross income an amount that is excluded from gross income under Part H (in particular, by the exemption for intra-group transactions in section HB 2(1)(a)). This problem in section LE 3(3)(e) did not exist before the Taxation (Core Provisions) Act 1996, which did not apply until the 1997-98 and subsequent income years.

Application date

The amendment to section LE 3(2) explicitly excluding consolidated groups from the section LE 3 holding company rules applies to dividends paid on or after the date the rules came into effect, on 12 December 1995.

The consequential amendment to section LE 3(3)(e) applies from the start of the 1997-98 income year, when the Taxation (Core Provisions) Act 1996 took effect.

Depreciation - property not yet in possession of owner

Section EG 2(1)(a) and (e), Income Tax Act 1994

A minor technical amendment ensures that property that a taxpayer owns but does not yet possess cannot be depreciated.

In September 1997 the depreciation provisions of the Income Tax Act 1994 were amended by the Taxation (Remedial Provisions) Act 1997 to provide that a deduction for depreciation would be permitted only when property was used or available for use in deriving gross income or in carrying on a business.

That amendment may not be effective in situations where depreciable property is owned by a taxpayer but not yet in the taxpayer's possession. For example, it can be argued that property that has been purchased but not delivered may still be depreciated.

The amendment remedies this so that such property is not depreciable until it is used or available for use in deriving income. Section EG 2(1)(a) and (e) have been amended to ensure that in all circumstances property must be used or available for use in business in order to be depreciable. Item c of the formula in paragraph (a) is now in the same terms as item g of the formula in paragraph (e).

The amendment applies to the 1998-99 and subsequent income years.

Depreciation - property under repair or inspection

Section EG 2(2A), Income Tax Act 1994

A minor technical amendment enables taxpayers to depreciate property that is under repair or inspection.

In September 1997 the depreciation provisions of the Income Tax Act 1994 were amended by the Taxation (Remedial Provisions) Act 1997 to provide that a deduction for depreciation would be permitted only when property was used or available for use in deriving gross income or in carrying on a business.

Property under repair or inspection is arguably not available for use by a business or in deriving gross income, and would therefore not be depreciable.

A new subsection EG 2(2A) has been inserted to provide that property continues to be available for use in deriving gross income or in carrying on a business if it is under temporary repair or inspection.

Subsection EG 2(2A) applies from 23 September 1997, the date the Taxation (Remedial Provisions) Act 1997 came into effect.

Depreciation - definition of "adjusted tax value"

Section OB 1, Income Tax Act 1994

Amendments have been made to the definition of "base value" and "aggregate deductions" in the definition of "adjusted tax value". This ensures that taxpayers can amortise the whole of the cost of the depreciable property used or available for use for business purposes.

Base value

The base value of an asset is generally its cost. However, if an asset is not immediately depreciable to a taxpayer (for example, because it is first used for private purposes) its base value is its market value at the time that it becomes depreciable.

Following recent depreciation amendments, property is not depreciable unless it is owned and used or available for use in business. If it is owned but not yet available for use, it is not immediately depreciable to the taxpayer, and in certain circumstances the base value of the property is its market value when it becomes available for use.

The definition of base value has been amended to ensure that if property is first used or available for use in business, it enters the tax base at cost – that is, paragraph (i) of item bv (base value) applies.

Aggregate deductions

At any time the maximum remaining depreciation that may be claimed for an asset is its tax book value. Before this amendment, the tax book value of an asset decreased from the time it was owned, even if not yet available for use. However, because taxpayers can now deduct depreciation for an asset only when it is available for business use, this decrease in the tax book value is penal and means that taxpayers cannot deduct all of the cost of an asset that is only ever available for business use.

The definition has been amended to effectively provide that an asset's tax book value decreases only during the period that the asset is used or available for use in a business or used for private purposes. It does not decrease over the period when an asset is unavailable for any use.

The amendment therefore ensures that all expenditure by a business on an asset, except that attributable to private use, is deductible over the life of the asset.

Application date

The amendments apply from 23 September 1997, the date on which the Taxation (Remedial Provisions) Act 1997 came into force.

Depreciation - "associated person" definition corrected

Section OD 8(3), Income Tax Act 1994

A minor error in section OD 8(3) has been corrected. The section provides a definition of "associated person" for the purposes of several provisions, including depreciation.

The error arose out of changes made to the depreciation legislation by the Taxation (Remedial Provisions) Act 1997.

The 1997 amendment to section OD 8(3) omitted two references to "paragraph (iv) of the item bv (base value) in the definition of "adjusted tax value'", in the expectation that they would no longer be required because of the insertion of a reference to Part EG. This is incorrect and the two references have been reinserted.

The amendment applies from 1 July 1997, the date on which the original amendments to section OD 8(3) came into force.

Confirmation of annual income tax rates for 1998-99

Schedule 1, Income Tax act 1994

The income tax rates for the 1998-99 income year have been confirmed as follows:

Income	Rate
Policyholder income	33 cents for every $1 of schedular taxable income
Maori authorities	25 cents for every $1 of taxable income
Undistributed rents, royalties and interest of the Maori Trustee	25 cents in every $1 of taxable income
Companies, public authorities and local authorities	33 cents for every $1 of taxable income
Trustee income (including that of trustees of superannuation funds)	33 cents for every $1 of taxable income
Trustees of group investment funds	33 cents for every $1 of schedular taxable income in respect of Category A income
Taxable distributions from non-qualifying trusts	45 cents for every $1 of taxable distribution
Other taxpayers (including individuals)	
• Income not exceeding $34,200	20 cents for every $1 of taxable income
• Income exceeding $34,200 but not exceeding $38,000	22.875 cents for every $1 of taxable income
• Income exceeding $38,000	33 cents for every $1 of taxable income
Specified superannuation contribution withholding tax	33 cents for every $1 of the contribution

The rates apply for the 1998-99 income year.

Notice of proposed adjustment

Sections 3 and 89F, Tax Administration Act 1994

When a notice of proposed adjustment (NOPA) is filed it must be accompanied by a cover sheet available from Inland Revenue. This is to allow Inland Revenue to identify it more readily and deal with it quickly.

A new process for resolving tax disputes came into effect on 1 October 1996. The role of the NOPA within this process is to notify the other party that an adjustment to an assessment is required. It formally initiates the disputes resolution process.

Although the Act prescribes what must be included in a NOPA, it did not require a particular form to be completed. A form (IR 210) has always been available from Inland Revenue for this purpose, but because the information required can vary considerably (depending upon the nature of the adjustment required) taxpayers and their agents often prefer to file the NOPA in the form of a letter. However, Inland Revenue has had difficulty identifying NOPAs immediately when they arrive in the form of a letter.

The definition of NOPA in sections 3 and 89F has been amended to require that NOPAs be accompanied by a prescribed cover sheet. The amendment will apply from 1 April 1999.

Privacy provisions

Section 62, Student Loan Scheme Act 1992

Inland Revenue is now allowed to supply the Ministry of Education with taxpayer information relating to a case that the Ministry is investigating when it suspects that a student loan has been fraudulently obtained, or that an attempt to obtain a loan fraudulently is being made. This will assist the Ministry of Education to investigate and prosecute fraud.

Over the last five years the Ministry of Education has investigated nearly 800 cases in which it suspects that a loan has been fraudulently obtained or that an attempt is being made to obtain a loan fraudulently. Although Inland Revenue and the Ministry of Education have separate roles in administering the student loan scheme, these roles are to a large degree interdependent.

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Before this amendment, Inland Revenue could release to the Ministry of Education only such information as is required to correctly identify a borrower.

Section 62, the privacy provision in the Student Loan Scheme Act 1992, has been amended to allow the Ministry of Education to request Inland Revenue to supply information about a taxpayer and his or her loan account. That information includes:

- whether repayments have been made;
- the individual's current loan balance;
- the current whereabouts of a borrower;
- whether someone is an existing taxpayer;
- the number of borrowers living at a particular address; and
- any other information that is relevant to the investigation.

The amendment applies from the date of enactment.

Taxation of specified superannuation contributions

Section NE 2, NE 2A, OB 1, Income Tax Act 1994

Introduction

Employees and employers can agree to have employer superannuation contributions included in employees' salary or wages and taxed at their personal tax rates.

Background

Under the current specified superannuation contribution withholding tax rules, employer contributions to superannuation funds are subject to a flat, final tax of 33%. The report to the Government from the Working Party on the Taxation of Life Insurance and Superannuation Fund Savings (April 1997) noted that this treatment resulted in employer contributions being over-taxed for employees whose effective marginal tax rate was below 33%.

The working party identified a number of options for taxing employer contributions to employee superannuation funds. In its report, it concluded that for employer contributions that vest immediately, the use of the existing PAYE mechanism already provided a relatively straightforward and effective way of dealing with the issue of over-taxation of employer contributions. In relation to contributions that do not vest immediately, the working party concluded that it could also be appropriate to adopt the same treatment proposed for contributions that vest immediately.

Inland Revenue issued a draft Standard Practice Statement late last year confirming that the current PAYE system could be used to tax employer superannuation contributions as salary or wages if employees agreed to this treatment. In response to submissions on the draft statement, it was decided it would be more appropriate to provide for an election in the legislation.

Employers and employees must agree that the employer superannuation contributions are to be treated as salary or wages. If they do not agree to this treatment the employer contribution will continue to be subject to specified superannuation contribution withholding tax.

Key features

The new section NE 2A will allow employees and employers to agree to have all or part of the employee's employer superannuation contributions included in the employee's salary or wages and therefore subject to PAYE. This will allow employees to have their employer superannuation contributions taxed at their personal tax rate. Employees will need to make an election, with the agreement of their employers, to have this treatment applied to their employer superannuation contributions. Employees will be able to revoke elections at any time.

If the contributions are treated as salary or wages of the employee, this amount will be taken into account for the targeting of social assistance such as family support, independent family tax credit, student loans and child support. Furthermore, this additional salary or wages will be subject to ACC premiums.

Application date

Employees and employers will be able to agree to have employer superannuation contributions treated as salary or wages from the date of enactment.

Fringe benefit tax - prescribed interest rate decreased to 6.94%

The prescribed rate of interest used to calculate the fringe benefit value of low interest employment-related loans has been decreased to 6.94% for the quarter beginning on 1 October 1998. This rate will continue to apply to subsequent quarters until any further adjustment is made.

The prescribed rate, down from 10.13%, is a reflection of the recent fall in market rates.

Standard practice statements

These statements describe how the Commissioner will, in practice, exercise a statutory discretion or deal with practical issues arising out of the administration of the Inland Revenue Acts.

Fast tracking small simple disputes

Standard practice statement INV-140

This standard practice statement outlines the Commissioner's criteria for settling small simple disputes and the procedures within Inland Revenue to fast-track them to resolution.

Background

On 1 October 1996 legislation introduced the disputes resolution process. Inland Revenue established a project team to document procedures and policies for resolving disputes in a 'typical' scenario. We deferred developing the fast-track procedures for small simple disputes until the impacts of the new regime could be considered.

This statement outlines options for fast tracking small disputes against a background principle of cost effective timely resolution. It covers:

- the criteria for small or simple disputes;
- the fast track process for small simple disputes; and
- the 'review' process for small simple disputes.

Small simple disputes

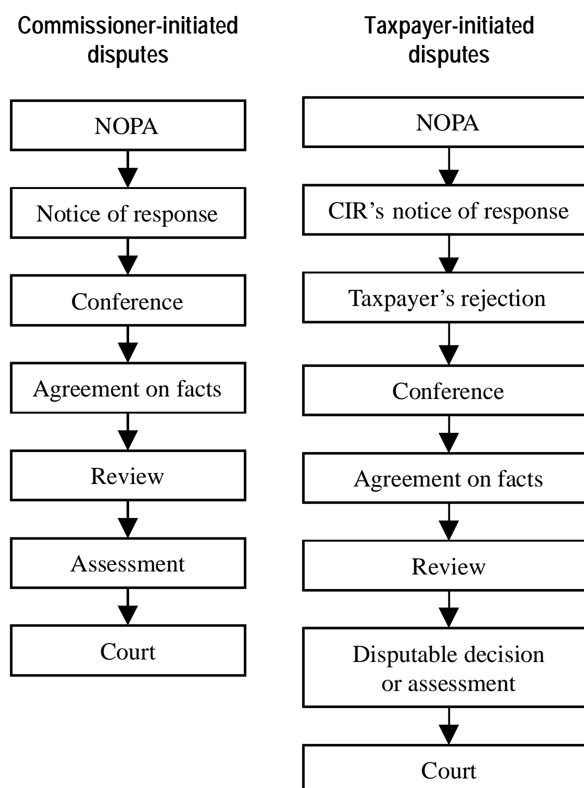
If a case meets the following criteria Inland Revenue will treat it as a small simple dispute:

- the facts are clear and not in dispute
- the total tax in dispute is less than $15,000
- there are no significant legal issues of precedent involved
- the issue is non-recurrent for the particular taxpayer.

A case will not be fast tracked if the Commissioner considers these criteria are not met. If the criteria are met but the taxpayer does not want the case to be fast tracked, the standard disputes process will be used.

Fast tracking procedures

The following fast track procedures will be used for small simple disputes:



Significant legal issues of precedent

A case will be considered to involve significant legal issues of precedent if it affects two or more taxpayers - e.g., a number of partners in a partnership or a number of employees of an employer.

In some circumstances there may be no connection between taxpayers but there is a common issue. For example, *CIR v Coveney and Anor* (1995) 17 NZTC 12,193; *Wattie and Anor v CIR* (1997) 18 NZTC 13,297. The outcomes of these two cases are likely to be persuasive or determinative of other cases where different taxpayers entered similar arrangements.

The decision as to whether a case involves significant legal issues of precedent will remain with Inland Revenue.

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Disclosure Phase – agreed statement of facts

The fast track procedures dispense with the formal disclosure phase. The purpose of the disclosure phase is to ensure that all parties have fully disclosed all the material they intend to rely on to support their position.

If the facts are clear and the issues non-precedential there should be no evidence or issues outstanding and little need for the protection of the evidence exclusion rule. Formal disclosure is therefore generally not warranted for small simple disputes. To ensure that all the facts have been disclosed and that they are clear and undisputed, an agreed statement of facts should be reached.

If the facts do not differ from those set out in the Notice of Proposed Adjustment or Notice of Response the agreed statement of facts may simply be a signed statement referring to those facts. If the facts have been updated since the issue of the Notice of Proposed Adjustment or the Notice of Response a separate document outlining the facts and evidence should be agreed.

At the end of this statement is a recommended statement for use where facts are agreed.

The Agreed Statement of Facts will precede the review, so Inland Revenue's reviewer can be satisfied that there are no further material facts that either party seeks to rely on.

Review

All fast tracked disputes will be subject to a final review before the Notice of Assessment or Notice of Disputable Decision is issued. The person reviewing the file will be a member of Inland Revenue's Technical Legal Support Group in the local Service Centre who has not previously had any involvement in the dispute.

The purpose of the review is to ensure that:

- the facts are clear and not in dispute
- the tax in dispute is less than $15,000
- there are no significant legal issues of precedent involved
- the issue is non-recurrent for the particular taxpayer
- the parties have agreed there are no outstanding facts
- the evidence disclosed and the law support the proposed adjustment.

Taxation Review Authority claims jurisdiction

Only a taxpayer can elect to use the Taxation Review Authority (TRA) small claims jurisdiction. If an issue is fast tracked within Inland Revenue there is no obligation on the taxpayer to use the small claims jurisdiction of the TRA. However, if the taxpayer elects the TRA small claims jurisdiction in their NOPA or Notice of Response that election is irrevocable and binding on the taxpayer. If a taxpayer indicates that they do not want to use the small claims jurisdiction the Commissioner will take this into account in deciding whether to agree to use a fast track option.

If the case is fast tracked within Inland Revenue and taxpayer does file their case in the TRA's small claims jurisdiction the Commissioner retains the right to apply to the TRA to move the case to a different hearing authority - section 138O of the Tax Administration Act 1994. This is likely to occur only if the taxpayer introduces new facts, evidence or legal argument that was not disclosed during the fast track process.

Shortfall penalties

It is probable that shortfall penalty adjustments will not meet the small simple dispute criteria in the short term. Except for evasion cases shortfall penalties are new and there is no case law on where the boundaries fall. Using the standard process when shortfall penalties are at issue will ensure consistency in applying the penalties, and if agreement cannot be reached Inland Revenue's Adjudication Unit will provide the independent review.

An example of a case involving shortfall penalties that could be fast tracked is failure to account for PAYE.

Recommended statement for use when facts are agreed

The following statements should be used when facts have been agreed.

"I, [taxpayer] agree that the facts outlined in [the NOPA, NOR, or other document*] are complete and form the basis of my position taken in this dispute.

"I, [team leader/senior investigator], on behalf of the Commissioner of Inland Revenue, agree that the facts outlined in [the NOPA, NOR or other document*] are complete and form the basis of Inland Revenue's position taken in this dispute."

* The document referred to in both statements must be the same.

Binding rulings

This section of the TIB contains binding rulings that the Commissioner of Inland Revenue has issued recently.

The Commissioner can issue binding rulings in certain situations. Inland Revenue is bound to follow such a ruling if a taxpayer to whom the ruling applies calculates tax liability based on it.

For full details of how binding rulings work, see our information booklet "Binding Rulings" (IR 115G) or the article on page 1 of TIB Volume Six, No.12 (May 1995) or Volume Seven, No.2 (August 1995). You can order these publications free of charge from any Inland Revenue office.

Forestry rights – secondhand goods GST input tax deduction

Public ruling BR Pub 98/5

Note *(not part of ruling): This ruling is essentially the same as public ruling BR Pub 95/3 which was published in TIB Volume Seven, No.3, September 1995, but its period of application is from 1 October 1998 to 30 September 2001 and some formatting changes have been made. BR Pub 95/3 applies up until 30 September 1998.*

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Goods and Services Tax Act 1985 unless otherwise stated.

This Ruling applies in respect of sections 2(1) (the definition of "input tax" at paragraph (c) and the definition of "secondhand goods") and 20(3).

The Arrangement to which this Ruling applies

The Arrangement is the supply to a GST registered person of a forestry right by way of sale in the following circumstances:

- The sale is not a taxable supply; and
- The right is situated in New Zealand at the time of supply; and
- The right is acquired by the registered person for the principal purpose of making taxable supplies; and
- The right has been used by at least one prior owner for its intrinsic purpose.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- A forestry right is a secondhand good for which an input tax deduction is available within the section 2(1) definitions of "input tax", paragraph (c), "secondhand goods", and section 20(3).

The period for which this Ruling applies

This Ruling will apply for the period 1 October 1998 to 30 September 2001.

This Ruling is signed by me on the 12th day of November 1998.

Martin Smith
General Manager (Adjudication and Rulings)

Commentary on public ruling BR Pub 98/5

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusion reached in public ruling BR Pub 98/5 ("the Ruling").

The subject matter covered in the Ruling was previously dealt with in public ruling BR Pub 95/3 (*Tax Information Bulletin* Volume Seven, No.3, September 1995 at page 1, under the heading *"GST: Secondhand goods input tax deduction for forestry rights"*). This Ruling extends that coverage to 30 September 2001.

Background

We had been asked to clarify whether a GST registered person who buys a forestry right by way of a non-taxable supply may make a secondhand goods input tax deduction. It had been unclear whether a forestry right can be a secondhand good.

Legislation

Section 2 of the Forestry Rights Registration Act 1983 defines "forestry right" (for the purposes of that Act):

"Forestry right" means a right granted by the grantor of any land to any other person to-

(a) Establish, maintain, and harvest; or

(b) Maintain and harvest,-

a crop of trees on that land, together with-

(c) Any ancillary rights of access and of constructing and using such tracks, culverts, bridges, buildings, and other works and facilities as may be necessary to establish,

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maintain, and harvest or, as the case may be, to maintain and harvest that crop; and

(d) Any provisions for charges, payments, royalties, or division of the crop or the proceeds of the crop,-

whether or not such rights or provisions are coupled with an obligation; but no such right shall be capable of conferring a right of exclusive possession of that land.

Section 3(1) of the Forestry Rights Registration Act 1983 states:

Notwithstanding any rule of law or equity to the contrary, every forestry right shall be deemed to be a *profit à prendre*.

Section 2(1) of the Goods and Services Tax Act 1985 defines "goods":

"Goods" means all kinds of personal or real property; but does not include choses in action or money.

Section 2(1)(c) defines "input tax" in relation to second-hand goods:

"Input tax", in relation to a registered person, means-

(c) Any amount equal to the tax fraction (being the tax fraction applicable at the time of supply within the meaning of section 9 or any other provision of this Act) of the consideration in money for the supply, being a supply by way of sale that is not a taxable supply, to a registered person of any secondhand goods situated in New Zealand, not being goods that are supplied by a supplier who-

(i) Is not resident in New Zealand; and

(ii) Has previously supplied the goods to a registered person who has entered them for home consumption under the Customs and Excise Act 1996,-

being in any case goods and services acquired for the principal purpose of making taxable supplies.

Section 20(3) allows deductions from output tax, and states:

Subject to this section, in calculating the amount of tax payable in respect of each taxable period, there shall be deducted from the amount of output tax of a registered person attributable to the taxable period-

(a) In the case of a registered person who is required to account for tax payable on an invoice basis pursuant to section 19 of this Act, the amount of input tax-

...

(ia) In relation to the supply of secondhand goods to which paragraph (c) of the definition of the term "input tax" in section 2(1) of this Act applies, to the extent that a payment in respect of that supply has been made during that taxable period:

...

(b) In the case of a registered person who is required to account for tax payable on a payments basis or a hybrid basis pursuant to section 19 of this Act, the amount of input tax-

(i) In relation to the supply of goods and services made to that registered person, being a supply of goods and services which is deemed to take place pursuant to section 9(1) or section 9(3)(a) or section 9(3)(aa) or section 9(6) of this Act, to the extent that a payment in respect of that supply has been made during the taxable period:

Application of the Legislation

Under sections 2(1) and 20(3), seven conditions must be met before the purchase of a forestry right by a GST registered person will permit a secondhand goods input tax deduction:

- Forestry rights must be "goods" as defined in section 2(1).
- The supply of a forestry right must be by way of sale.
- The supply of the forestry right must be a non-taxable supply.
- The sale must involve payment in the taxable period for which an input tax deduction is sought.
- The forestry right must be secondhand.
- The forestry right must be acquired for the principal purpose of making taxable supplies.
- The forestry right must be situated in New Zealand at the time of sale.

The following paragraphs consider some of these requirements.

"Goods"

The Commissioner considers that a forestry right (as defined in section 2 of the Forestry Rights Registration Act 1983) is a "good" for GST purposes. "Goods" means all real and personal property but does not include choses in action. Section 3(1) of the Forestry Rights Registration Act 1983 deems forestry rights to be *profits à prendre.* This confirms the common law position that a forestry right is a *profit à prendre*. A *profit à prendre* is a right to take something off another person's land. A *profit à prendre* is an interest in land. It is not a chose in action because the rights under a *profit à prendre* are of a possessory nature, whereas a chose in action can only be enforced by action. An example of a "chose in action" is the granting of a licence at a boat marina. The benefits arising from the licence cannot be obtained by taking possession of the licence, but by action against a licensor who refuses to honour the licence. On the other hand, a forestry right, which can be enforced by taking possession, is real property and a "good" for GST purposes.

"Sale"

A secondhand goods input tax deduction is only available if there is a supply by way of sale. Forestry rights are a form of transferable property right, like other *profits à prendre*, and may be sold. It will be a question of fact whether there has been a sale rather than a lease or sub-grant of a forestry right. Because of the definition of "input tax" in paragraph (c), a secondhand goods input tax deduction is available only where there is a sale.

The sale must be by way of a non-taxable supply for an input tax deduction to be available.

"Payment"

An input tax deduction is only available to the extent that there has been payment for the goods in the relevant taxable period. Therefore, if there is a sale by instalments, input tax deductions are available only in the taxable period in which each instalment is paid.

"Secondhand"

The forestry right must be "secondhand" before an input tax deduction is available. The Commissioner considers that land is a secondhand good. This is supported by case law, e.g. *Case N13* (1991) 13 NZTC 3,105. The Court of Appeal decision in *Coveney v CIR* (1995) 17 NZTC 12,193 appears to have confirmed this view, notwithstanding earlier obiter dicta that land may not be a secondhand good in *L R McLean v CIR* (1994) 16 NZTC 11,211 (CA) and *King v Bennetts* (1994) 16 NZTC 11,370.

However, when a specific interest in land, like a forestry right, is newly created, it is a unique mix of rights distinct from the original land over which it was created. Accordingly, the original grant of a forestry right cannot be a sale of secondhand goods. The forestry right is a new item of property. Before a forestry right can be a secondhand good, at least one prior owner must have made use of the right for its intrinsic purpose which is to take trees from the land, *L R McLean v CIR* (CA).

Therefore, as long as the prior owner has exercised this right by physically removing trees, the forestry right will constitute a secondhand good when sold.

Example

Purchaser is a GST registered person who intends to enter the forestry industry in a small way. On 1 July 1996 she buys a forestry right from Supplier, who is not registered for GST. Supplier had bought the right 18 months earlier from a farmer who had decided not to diversify into forestry. Supplier had used the right on a small scale to remove a small amount of timber. The purchase price is $20,000 payable in four quarterly instalments. The first payment is made on 1 August 1996.

Purchaser is entitled to a secondhand goods input tax deduction because the forestry right was disposed of by sale, the seller was unregistered (non-taxable supply), the forestry right was secondhand, and Purchaser acquired the right for the principal purpose of making taxable supplies. In Purchaser's next GST return (for the two months ending 31 August 1996) she should deduct as input tax the tax fraction of the amount of the first instalment ($5,000). Accordingly, she may deduct $555.55.

Netherlands social security pensions - taxation when the recipient is a New Zealand resident

Public ruling BR Pub 98/6

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Law

All legislative references are to the Income Tax Act 1994 ("the Act"), and to the Double Taxation Convention between the Netherlands and New Zealand (which appears in the Schedule to the Double Taxation Relief (Netherlands) Order 1981, S.R. 1981/43) hereinafter referred to as "the Double Taxation Convention".

This Ruling applies in respect of Article 19(2) of the Double Taxation Convention.

The Arrangement to which this Ruling applies

The Arrangement is the periodic payment of a Netherlands social security pension to a person who is a resident of New Zealand, and there is no arrangement with the Department of Work and Income under section 70(3) of the Social Security Act 1964 to pay the person's Netherlands pension to that Department in order to receive the full rate of a benefit or benefits under that Act or the Social Welfare (Transitional Provisions) Act 1990.

If the recipient of such a pension is also eligible to receive a benefit or benefits under New Zealand's social welfare legislation and a reduction has been made to that New Zealand benefit by the Department of Work and Income under section 70(1) of the Social Security Act 1964, the Ruling only applies to the extent of the amount of the Netherlands pension over and above the amount of the reduction.

This person may be a national of the Netherlands, or of New Zealand, or of both countries.

For the purposes of this Ruling the word "national" has the meanings attributed to it by Article 3, paragraph 1.h of the Double Taxation Convention.

How the Taxation Law applies to the Arrangement

The Taxation Law applies to the Arrangement as follows:

- When a New Zealand resident receives a Netherlands social security pension, and that person is also a New

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Zealand citizen, the pension is taxable only in New Zealand.

- When a New Zealand resident, who is not a New Zealand citizen, receives a Netherlands social security pension, the pension may be subject to tax in both the Netherlands and New Zealand; the Commissioner giving a credit for tax paid in the Netherlands in accordance with New Zealand's foreign tax credit rules.

The period for which this Ruling applies

This Ruling will apply for the period from 1 December 1998 to 30 November 2001.

This Ruling is signed by me on the 17th day of November 1998.

Martin Smith
General Manager (Adjudication & Rulings)

Commentary on public ruling BR Pub 98/6

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in public ruling BR Pub 98/6 ("the Ruling").

Background

Confusion has arisen as to the New Zealand tax treatment of social security pensions paid by the Netherlands Government to people living in New Zealand. Some taxpayers believe that the pensions are not taxable in New Zealand if the recipients are not New Zealand citizens.

Legislation

Section BD 1(2) states:

An amount is not gross income of a taxpayer if it is…

(c) a foreign-sourced amount and the taxpayer is a non-resident when it is derived.

Article 19(2) of the Double Taxation Convention reads as follows:

a. Any pension paid by, or out of funds created by, one of the States or a political subdivision or a local authority thereof to an individual in respect of services rendered to that State or subdivision or authority and any pension paid to an individual under the social security scheme of one of the States, may be taxed in that State.

b. However, such pension shall be taxable only in the State of which the individual is a resident if he is a national of that State.

Article 3(1)(h) defines the term "national" to mean:

1. in the case of the Netherlands, any individual possessing the nationality of the Netherlands, and any legal person, partnership and association deriving its status as such from the laws in force in the Netherlands;
2. in the case of New Zealand, any individual possessing citizenship of New Zealand and any legal person, partnership and association deriving its status as such from the laws in force in New Zealand.

Article X of the Protocol to the Double Taxation Convention states:

X. With reference to Articles 18 and 19

It is understood that the term "pensions and other similar remuneration" includes only periodical payments.

Application of the Legislation

Under the Income Tax Act 1994, persons who are resident in New Zealand are subject to New Zealand tax on their worldwide income. Double Taxation Conventions with other countries override the Income Tax Act and determine which country has jurisdiction to tax the income in question. Among other issues the Double Taxation Convention between the Netherlands and New Zealand determines the tax treatment of periodic pensions paid by an organisation in one country to residents of the other country.

Article 18 of the Double Taxation Convention sets out which country has the jurisdiction to tax pensions paid by one country to the residents of the other country. This article, however, does not apply to pensions paid out:

- under social security schemes, or
- for services rendered to the country paying the pension.

Instead, Article 19 defines which country may tax these pensions. Article 19(2)(a) states that the country paying a social security pension **may** tax the pension. The use of the word "may" in this Article permits both the country of residence and the country paying the pension to tax the pension. If the pension is taxed by both countries, the country of residence will credit the recipient with the amount of tax deducted by the country paying the pension. New Zealand will do this under its foreign tax credit rules in Subpart LC of the Income Tax Act 1994.

Article 19(2)(b) limits the application of Article 19(2)(a). It provides for the pension to be "taxable **only** in the State of which the individual is a resident if he is a national of that State", thereby giving the State of residence an exclusive right to tax the pension when the recipient is a national of that State.

The Double Taxation Convention defines a person to be a national of New Zealand when that person is a citizen of New Zealand. Accordingly, under Article 19(2)(b) New Zealand will have an exclusive right to tax a Dutch social security pension when the New Zealand resident recipient is a New Zealand citizen. (This will be so whether or not that person is also a Dutch national. In the case of dual nationality, the recipient will still satisfy the requirements of Article 19(2)(b) - New Zealand

residency and citizenship - and the additional fact of possessing Dutch nationality will not alter the conclusion that only New Zealand may tax the pension.)

However, if the pensioner is resident in New Zealand and is not a New Zealand citizen, New Zealand will not have an exclusive right to tax the pension but may do so. The Netherlands may tax the pension at the time that it is paid to the New Zealand resident. People who are not New Zealand citizens and have tax deducted by the Dutch Government from their Netherlands social security pensions are entitled to tax credits under section LC 1. When this occurs the Commissioner will, in accordance with New Zealand's foreign tax credit rules, give the recipient a tax credit for the tax paid in the Netherlands. However, these tax credits cannot exceed the amount of tax due in New Zealand.

It is intended that the Ruling will apply only to those Netherlands social security pensions that are paid **directly** to New Zealand residents and the value of which is more than any New Zealand benefit or benefits that are received. If the recipient has entered into an arrangement with the Chief Executive of the Department of Work and Income to reduce any benefit according to the amount received from the Netherlands, or to receive the full rate of a social welfare benefit in return for the Netherlands social security pension (section 70 of the Social Security Act 1964 applying in these cases), then to the extent that the Netherlands pension is reduced by these arrangements, it is exempt from income tax. That is, paragraphs (f) and (fa) of section CB 5(1) would apply in those circumstances.

Example 1

A taxpayer is a Dutch citizen who emigrated to New Zealand two years ago. He receives a Netherlands social security pension. He has not become a New Zealand citizen, but is a tax resident of New Zealand.

Both New Zealand and the Netherlands may tax his pension. New Zealand will grant him a tax credit for the tax charged on the pension by the Netherlands.

Example 2

A taxpayer also has Dutch nationality and emigrated to New Zealand five years ago. She likewise receives a Netherlands social security pension. Unlike the taxpayer in Example 1 she has become a New Zealand citizen.

Only New Zealand may tax the social security pension that she receives from the Netherlands.

Easements - deductibility of the costs of preparation, stamping, and registration

Public ruling BR Pub 98/7

This is a public ruling made under section 91D of the Tax Administration Act 1994.

Taxation Laws

All legislative references are to the Income Tax Act 1994 unless otherwise stated.

This Ruling applies in respect of sections DJ 11, BD 2(2)(e), EF 1(5), and the section OB 1 definitions of: "estate" or "interest", "lease", and "leasehold estate".

The Arrangement to which this Ruling applies

The Arrangement is the tax deductibility of expenditure incurred in the preparation, stamping, and registration of easements used in the derivation of the taxpayer's gross income.

How the Taxation Laws apply to the Arrangement

The Taxation Laws apply to the Arrangement as follows:

- Easements will be treated as leases for the purposes of section DJ 11.
- The Commissioner will allow a deduction for costs incurred by a taxpayer in the preparation, stamping, and registration of easements where they are used in the derivation of the taxpayer's gross income, in the income year in which the expenditure is incurred.

The period for which this Ruling applies

This Ruling will apply for the period 1 January 1999 to 31 March 2002.

This Ruling is signed by me on the 30th day of November 1998.

Martin Smith
General Manager (Adjudication & Rulings)

Commentary on public ruling BR Pub 98/7

This commentary is not a legally binding statement, but is intended to provide assistance in understanding and applying the conclusions reached in Public Ruling BR Pub 98/7 ("the Ruling").

Background

Land may have its utility enhanced by the right to the use of an easement. Once registered an easement gives an interest in the land that is of enduring benefit.

Subject to the exercise of the Commissioner's discretion, section DJ 11 permits a deduction for the costs of the preparation, stamping, and registration of "any lease of property used in the derivation of the taxpayer's gross income". The issue is whether an easement is a "lease of property" as defined in the Act.

Legislation

Section DJ 11 states:

The Commissioner may allow such deduction as the Commissioner thinks fit in respect of expenditure incurred by a taxpayer during an income year for the preparation, stamping, and registration of any lease of property used in the derivation of the taxpayer's gross income, of any renewal of any such lease, or in the borrowing of money employed by the taxpayer as capital in the derivation of gross income.

Section BD 2(2) specifically excludes certain expenditure or losses as allowable deductions from gross income derived by a taxpayer. Relevant for the purposes of this Ruling is the section BD 2(2)(e) exclusion for expenditure or loss of a capital nature which states:

An amount of expenditure or loss is not an allowable deduction of a taxpayer to the extent that it is

...

(e) of a capital nature, unless allowed as a deduction under Part D (Deductions Further Defined) or E (Timing of Income and Deductions), or

Section EF 1(5)(d) states:

The amount of the unexpired portion (if any) of any amount of accrual expenditure of any person to be taken into account in any income year shall be -

...

(d) Where the expenditure relates to a payment for, or in relation to, a chose in action, the amount that relates to the unexpired part of the period in relation to which the chose is enforceable.

The following are defined terms in section OB 1:

"Estate" or **"interest"**, in relation to land, means any estate or interest in land, whether legal or equitable, and whether vested or contingent, in possession, reversion or remainder; and includes any right to the possession of land or to receipt of the rents or profits from the land, or to the proceeds of the sale or other disposition of the land, whether immediate or through a trustee, or otherwise; but does not include a mortgage:

"Interest" -

...

(b) In relation to land, has the same meaning as **"estate"**

"Lease" -

(a) Except as provided in paragraphs (b), (d), (e), and (f) means any disposition whatever by which a leasehold estate is created:

"Leasehold estate" includes any estate however created, other than a freehold estate:

Application of the Legislation

The nature of an easement

The essential elements of an easement, as developed by common law, are that:

- there must be a dominant tenement and a servient tenement (*Hawkins v Rutter* [1892] 1 QB 668); and
- the easement must accommodate the dominant tenement such that it is related to the utility of the land and must do more than confer a personal benefit on the owner of the land (*Re Ellenborough Park* [1955] 3 All ER 667); and
- the dominant owner and servient owner must be different persons (*Metropolitan Rly Co v Fowler* [1892] 1 QB 165); and
- the easement must be capable of forming the subject matter of the grant (*Re Ellenborough Park*).

In New Zealand the common law elements of an easement have been modified by statute. The statutory modification has created "easements in gross". Section 122 of the Property Law Act 1952 allows the creation of easements in gross. An easement in gross is one where there is no requirement for a dominant tenement. The right created by the easement is not appurtenant to another parcel of land. This modifies the first element of a common law easement, that there be a dominant and servient tenement.

While statute permits an easement where there is no dominant tenement, there must be a servient tenement. This is necessary, for if the right granted by the easement arises from ownership of the land, there is no requirement to claim that right as an easement as it already exists.

Two other features of an easement, while not defining characteristics, further describe the rights and limitations of an easement:

- An easement permanently binds the land over which the right is exercised, and similarly subsists permanently for the benefit of the dominant tenement. One issue that arises is whether the rule against perpetuities applies to an easement. If the right created by the easement vests immediately with the grantee, authority indicates that the rule against perpetuities does not apply (*Ellison v Vukicevic* (1986) 7 NSWLR 104).

- The notion that an easement cannot and does not confer a right to possession in the land over which the right is granted (*Copeland v Greenhalf* [1952] 1 All ER 809).

An easement is a lease for the purposes of the Act

Although an easement is not an estate in land, it is an interest in land as contemplated by the law of real property. In *Auckland City Council v Man O'War Station Limited* [1996] 3 NZLR 460, Anderson J observed:

> An easement ... is an incorporeal hereditament, which is a right in respect of land, and therefore an **interest** in land, but it is not land in the tangible sense nor an **estate** in land in the common law sense. [page 465] [emphasis added]

An easement may be distinguished from other lesser rights such as a licence. A licence is a personal right and so does not pass an interest in the land in the way that an easement does (*Errington v Errington* [1952] 1 All ER 149 and *Thomas v Sorrell* (1673) 124 E.R. 1098).

A lease, as contemplated in the law of real property, is an estate of less than freehold. Estates of less than freehold exist where the duration of the estate is certain or capable of being made certain (*Charles Clay & Sons Ltd v British Railways Board* [1971] 1 All ER 1007). Adams EC (Ed) in *Garrow's Law of Real Property* (Butterworths, Wellington 1961) categorises leases whether for a fixed term, at will, or at sufferance as the estates of less than freehold.

For the purposes of the Act, a "lease" is defined in section OB 1 as any disposition by which a "leasehold estate" is created. An easement is created by a disposition of property. The owner of the fee simple which will become the servient tenement surrenders, or disposes of, part of his or her right in the land to another person. Also implicit in the definition is that the disposition must **create** a leasehold estate. That is, the disposition must not be one that, for example, **transfers** the leasehold estate in the land. An easement qualifies, as it is not a transfer of any interest in the land but the creation of an interest in the land, a right that attaches to land so that it may improve its use and benefit.

"Leasehold estate" is also defined, as any estate however created, other than a freehold estate. The concept of a "freehold estate" was developed by common law. A freehold estate is one of uncertain duration: the feature that distinguishes it from an estate of less than freehold, i.e. a lease. In the case of individuals it is uncertain as it is measured by reference to their lives. For corporations, it is uncertain, as they may continue on indefinitely. There are three types of freehold estates in New Zealand: the fee simple which will enure until the holder of the estate dies intestate without heirs, the life estate which will continue only for the life of the holder and is extinguished on that person's death, and the stratum estate created by section 4(2) of the Unit Titles Act 1972.

The term "estate", also defined in the Act, is coupled with the word "interest". "Interest" is defined as having in relation to land the same meaning as "estate". For the purposes of the Act, therefore, the terms "estate" or "interest" are merged and treated synonymously.

An easement is an interest in land. A lease is an estate in land. The term "lease" is the nomenclature used in the Act for estates or interest in land unless specifically excluded, such as estates of freehold and mortgages. An easement as an interest in land is therefore a "lease" as defined in the Act, and section DJ 11 applies to the costs of preparation, stamping, and registration of easements.

Exercise of the Commissioner's discretion

A deduction for the costs of preparation, stamping, and registration of an easement under section DJ 11 is subject to the exercise of the Commissioner's discretion. There exists no direct case authority on how the Commissioner should exercise the discretion conferred upon him in section DJ 11. The words granting the discretion do not fetter the exercise of the Commissioner's discretion. In this respect the Commissioner is bound only to act fairly and according to the law (*Gisborne Mills Ltd & Ors v C of IR* (1989) 11 NZTC 6194, *Reckitt & Coleman (NZ) Limited v Taxation Board of Review* [1966] NZLR 1032 and *Lowe v C of IR* (1981) 5 NZTC 61,006).

Discussed below are two legislative provisions considered by the Commissioner as relevant in exercising the discretion conferred in section DJ 11.

The first is the capital/revenue distinction. The costs of preparation, stamping, and registration of an easement are typically for most taxpayers, capital expenditure. This view is based on the one-off nature of the expenditure, the enduring nature of the benefit, and that land generally is part of the taxpayer's business structure. Capital expenditure as such is non-deductible under section BD 2(2)(e), unless the Act expressly permits otherwise. Deductions allowed in part D of the Act, which includes section DJ 11, are an expressly permitted exception to the non-deductibility of capital expenditure contained in section BD 2(2)(e). To give effect to section DJ 11, it is necessary that a deduction for such expenditure is not disallowed on the basis that the expenditure is capital in nature.

The second provision considered is spreading deductibility, for the costs of preparation, stamping, and registration of an easement, under section EF 1. Essentially, section EF 1 adds back as income the unexpired portion of any expenditure incurred. As such it is a qualification to the general rule that a deduction for expenditure is available when it is incurred. Section EF 1 does not operate to deny a deduction, but is a provision directed to the timing of the deduction.

If an allowable deduction is subject to a timing regime, the Commissioner must, under section BD 4(2), allocate the deduction to an income year in accordance with that regime. If the lease is a conventional lease which is for a term certain, the provisions of section EF 1 may be

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readily applied. Where the lease is one, such as an easement, which runs with the land, it may be considerably more uncertain as to the application of section EF 1. Relevant for this discussion is section EF 1(5)(d) which deals with the spreading of deductions for choses in action.

The uncertainty arises as an easement is an incorporeal hereditament, enforced by action, and therefore a chose in action. A chose in action is a term used "to describe all personal rights of property which can only be claimed or enforced by action, and not by physical possession" (*Torkington v Magee* [1902] 2 KB 427, 430).

One of the elements of section EF 1(5)(d) is the requirement to add back the amount of expenditure "that relates to the unexpired part of the period in relation to which the chose is enforceable". Important in this respect is the concept of "period".

The notion of a period has two elements:

- it is a continuous and unbroken duration of time; and
- it is an interval with a commencement point in time and a point of determination.

Therefore, a period has the connotation of a continuous interval of time for which there is a commencement point and a point of cessation (*London & India Docks* 9 T.L.R. 11, and *JLG Investments v Sandwell District Council* [1978] E.G. 845).

In applying the notion of a period to an easement, it is arguable that all expenditure incurred would be added back. As an easement runs with the land, subsisting permanently for the benefit of the dominant tenement, the total expenditure will be added back as the unexpired portion. Applying this reasoning, section EF 1 would operate to disallow a deduction, notwithstanding that the easement had been used, as part of an interest in the land, to derive gross income. As was emphasised by the Court of Appeal in *Thornton Estates Ltd v C of IR* (1998) 18 NZTC 13,577, section EF 1 spreads the timing of the deduction; it does not prohibit a deduction.

An alternative approach to section EF 1 would be to add back the costs of preparation, stamping, and registration of an easement in each period until the easement is no longer enforceable by the taxpayer, (i.e. no part of the effect of the expenditure is treated as spent in relation to the taxpayer until that taxpayer disposes of his or her interest in the land benefiting from the easement.) This interpretation assumes that the end point of a "period" need not be certain while the time is running.

The difficulty with this interpretation is that it does not distinguish between an uncertain period and no period. An easement has no period as it runs with the land indefinitely - it does not have a point of determination. A further potential issue with adopting the alternative view, is that if a taxpayer such as a corporation never disposes of the land benefiting from the easement, then the taxpayer may never receive a deduction.

It is considered that the better view of the law is that expenditure incurred in the preparation, stamping, and registration of easements is deductible when it is incurred. This approach is consistent with the view that expenditure for the preparation, stamping, and registration of easements may be allowed when incurred, under section DJ 11. It is also consistent with the view that an easement has no period over which the expenditure may be spread, and so the provisions of section EF 1 do not apply, and that any method otherwise used by the Commissioner to spread the deduction would inevitably be arbitrary and subjective.

Incurred expenditure allowable by the Commissioner

In considering the deductibility of expenditure incurred in the preparation, stamping and registration of easements it is difficult, if not impossible, to identify the types of expenditure that may or may not meet the statutory character specified. For this reason the Ruling does not specify what expenditure comes within, and what is outside, that criteria. Rather, the character will be established by showing that the expenditure is for the preparation, stamping, and registration of the easement, such easement being used in the derivation of the taxpayer's gross income. There is, however, one exception and it is of particular relevance to the element of "preparation".

It is not uncommon for the owner of what will become the servient tenement to receive a sum of money for granting the easement. Is such a payment part of the easement's "preparation"?

The word "preparation" has not being judicially considered in terms of section DJ 11. However, the word "preparation" or "prepare" has been considered judicially (*Horsley v Collier and Cartly Ltd* [1965] 2 All ER 423 and *Calabria v R* [1982] 151 CLR 671). Those cases point to the word "preparation" indicating something that is done prior to it being ready for its use. In the case of an easement, until the right to create is granted there is nothing to prepare. A payment for the right to create an easement is the consideration that allows its "preparation" to be commenced. While it is a question of degree whether the expenditure incurred has the required nexus with the preparation of the easement to be deductible, a payment made for the grant of an easement lacks sufficient nexus to be within section DJ 11. Such payments to the owner of the servient land for the **right** to create an easement, which are not deductible, are distinguishable from payments made for the preparation, stamping, and registration of an easement, which, in some instances may also be made to the owner of the servient land, and are deductible, e.g. a payment made to the owner of the servient tenement equal to the owner's costs incurred on legal and survey fees.

Comments on technical submissions received

One submission received suggested that section EF 1 may not apply because there may be no unexpired portion in respect of expenditure made. This could occur, for example, where the solicitor preparing, stamping, and registering the easement had fully performed his or her contractual obligation in consideration for the payment received.

However section EF 1 requires that expenditure which "relates to a payment for, or in relation to..." a chose in action is spread with reference to the unexpired portion of the period that the chose is enforceable. In interpreting the phrase "relates to a payment for, or in relation to..." case authority indicates that it should be given a wide rather than a narrow interpretation (*Shell New Zealand Ltd v C of IR* (1994) 16 NZTC 11,303, *Picture Perfect Ltd v Camera House Ltd* [1996] 1 NZLR 310 and *Slattery (Trustee of) v Slattery* [1993] 2 CTC 243). The phrase also imports a concept of connection or nexus between the expenditure incurred and "something". The expenditure on the legal fees must relate to, or be in relation to "something". Where that expenditure "relates to a payment for, or in relation to" a chose, section EF 1(5)(d) requires that the amount relating to the unexpired portion of the chose is added back.

The better view of the law is that the cost incurred in the preparation, stamping, and registration of an easement is expenditure that "relates to a payment for, or is in relation to," a chose. As noted above an easement is a chose that has no period over which the unexpired portion may be spread, and it is for this reason that section EF 1 does not apply.

Example

Farmer Ltd is a company conducting its agricultural and horticultural activities in an area where rainfall is limited and there is no natural irrigation. Farmer Ltd arranges for irrigation to be provided to the property. This requires reticulation across a neighbouring property. Farmer Ltd incurs survey costs and legal fees in the preparation, stamping, and registration of the easement allowing the diverted water to be transported to Farmer Ltd's property. Farmer Ltd agrees to pay the owner of the neighbouring property a one-off lump sum payment for the **right** to create the easement. In addition, the owner of the dominant tenement, Farmer Ltd, agrees to pay the legal costs for reviewing and approving the drafted easement's documentation incurred by the owner of the neighbouring property, i.e. the owner of the servient tenement.

The survey costs and legal fees, including those paid for the owner of the neighbouring property, are costs for the preparation, stamping, and registration of the easement and so are deductible in the income year in which they are incurred. The cost of the irrigation scheme itself is not part of the costs of preparation, stamping, and registration of the easement. The one-off payment to the owner of the neighbouring property for the **right** to create the easement is not for the preparation, stamping, and registration of the easement and therefore is not deductible.

Booklets available from Inland Revenue

This list shows all of Inland Revenue's information booklets as at the date of this Tax Information Bulletin. There is also a brief explanation of what each booklet is about.

Some booklets could fall into more than one category, so you may wish to skim through the entire list and pick out the booklets that you need. To order any of these booklets, call the forms and stationery number listed under "Inland Revenue" in the blue pages at the front of your phone book. This is an automated service, and you'll need to have your IRD number handy when you call.

We publish this list in the TIB every March, June, September and December. Updates are available at other times from our website at http://www.ird.govt.nz. You can also download many of these booklets from our website.

General information

Binding rulings (IR 115G) - Mar 1998:*Explains binding rulings, which commit Inland Revenue to a particular interpretation of the tax law once given.*

Cash assistance for your growing family (FS 4) - Mar 1997: *Information about Family Assistance and how to apply.*

Disputing a notice of proposed adjustment (IR 210K) - Oct 1996: *If we send you a notice to tell you we're going to adjust your tax liability, you can dispute the notice. This booklet explains the process you need to follow.*

Disputing an assessment (IR 210J) - Oct 1996:*Explains the process to follow if you want to dispute our assessment of your tax liability, or some other determination.*

Gift duty (IR 654) - Jun 1998:*Explains the duty payable on gifts.*

How to tell if you need a special tax code (IR 23G):*Information about getting a special "flat rate" of tax deducted from your income, if the regular deduction rates don't suit your particular circumstances.*

If you disagree with us (IR 210Z) - Sep 1996:*This leaflet summarises the steps involved in disputing an assessment.*

Income from a Maori Authority (IR 286A) - Feb 1996:*For people who receive income from a Maori authority. Explains which tax return the individual owners or beneficiaries fill in and how to show the income.*

Independent Family Tax Credit (FS 3) - Sep 1996:*Introducing extra help for families, applying from 1 July 1996.*

Inland Revenue audits (IR 297) - Mar 1998:*For business people and investors. It explains what is involved if you are audited by Inland Revenue; who is likely to be audited; your rights during and after the audit, and what happens once an audit is completed.*

Maori Community Officer Service (IR 286) - Apr 1996:*An introduction to Inland Revenue's Maori Community Officers and the services they provide.*

New secondary tax codes and extra emolument rates (IR 184R) - May 1998:*Explains the new rates and codes available from 1 July 1998.*

New Zealand tax residence (IR 292) - Jun 1997:*An explanation of who is a New Zealand resident for tax purposes.*

Overseas private pensions (IR 258A) - Oct 1996:*Explains the tax obligations for people who have interests in a private superannuation scheme or life insurance annuity policy that is outside New Zealand.*

Overseas social security pensions (IR 258) - Jun 1997:*Explains how to account for income tax in New Zealand if you receive a social security pension from overseas.*

Payments and gifts in the Maori community (IR 278) - April 1998: *A guide to payments in the Maori community - income tax, PAYE and GST consequences.*

Provisional tax (IR 289) - Jun 1998:*People whose end-of-year tax bill is $2,500 or more must generally pay provisional tax for the following year. This booklet explains what provisional tax is, and how and when it must be paid.*

Putting your tax affairs right (IR 282) - Jun 1997:*Explains the advantages of telling Inland Revenue if your tax affairs are not in order, before we find out in some other way. This book also sets out what will happen if someone knowingly evades tax, and gets caught.*

Rental income (IR 264) - Jun 1998:*An explanation of taxable income and deductible expenses for people who own rental property. This booklet is for people who own one or two rental properties, rather than larger property investors.*

Reordered Tax Acts (IR 299) - Apr 1995:*In 1994 the Income Tax Act 1976 and the Inland Revenue Department Act 1974 were restructured, and became the Income Tax Act 1994, the Tax Administration Act 1994 and the Taxation Review Authorities Act 1994. This leaflet explains the structure of the three new Acts.*

Self-employed or an employee? (IR 186) - Jun 1997:*Sets out Inland Revenue's tests for determining whether a person is a self-employed contractor or an employee. This determines what expenses the person can claim, and whether s/he must pay ACC premiums.*

Stamp duty (IR 665) - Jun 1998:*Explains what duty is payable on transfers of real estate and some other transactions. Written for individual people rather than solicitors and legal firms.*

Student Loans - going overseas (SL 13) - Aug 1998:*A brief guide to the student loan obligations of a borrower who goes overseas. This information is also included in the SL 5 booklet listed below.*

Student Loans - how to get one and how to pay one back (SL 5) - 1998: *We've published this booklet jointly with the Ministry of Education, to tell students everything they need to know about getting a loan and paying it back.*

Student Loans - interest and calculations (SL 12) - Aug 1998: *A brief guide how the interest on a student loan is calculated. This information is also included in the SL 5 booklet listed above.*

Student Loans - making repayments to Inland Revenue (SL 14) - Aug 1998:*A brief guide to repaying your student loan. This information is also included in the SL 5 booklet listed above.*

Superannuitants and surcharge (IR 259) - Jun 1997:*A guide*

to the surcharge for national superannuitants who also have other income.

Tax facts for income-tested beneficiaries (IR 40C) - Aug 1997: *Vital information for anyone who receives an income-tested benefit and also has some other income.*

Taxes and duties (IR 295) - May 1995: *A brief introduction to the various taxes and duties payable in New Zealand.*

Taxpayer obligations, interest and penalties (IR 240) - Jan 1997: *A guide to the new laws dealing with interest, offences and penalties applying from 1 April 1997.*

Trusts and estates - (IR 288) - May 1995: *An explanation of how estates and different types of trusts are taxed in New Zealand.*

Visitor's tax guide - (IR 294) - Nov 1995: *A summary of New Zealand's tax laws and an explanation of how they apply to various types of visitors to this country.*

Business and employers

ACC premium rates (ACC 450) - Mar 1998: *This book provides the rates of employer premium for employers and self-employed. The rates apply to earnings for the year ended 31 March 1998.*

Dairy farming (IR 252) - Jul 1998: *A guide to GST and PAYE obligations of dairy farmers.*

Depreciation (IR 260) - Apr 1994: *Explains how to calculate tax deductions for depreciation on assets used to earn assessable income.*

Direct selling (IR 261) - Aug 1996: *Tax information for people who distribute for direct selling organisations.*

Electronic payments to Inland Revenue (IR 87A) - Sep 1997: *Explains how employers and other people who make frequent payments to Inland Revenue can have these payments automatically deducted from their bank accounts.*

Employer's guide (IR 184) - Feb 1998: *Explains the tax obligations of anyone who is employing staff, and explains how to meet these obligations. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

Entertainment expenses (IR 268) - May 1995: *When businesses spend money on entertaining clients, they can generally only claim part of this expenditure as a tax deduction. This booklet fully explains the entertainment deduction rules.*

First-time employer's guide (IR 185) - April 1996: *Explains the tax obligations of being an employer. Written for people who are thinking of taking on staff for the first time.*

Fringe benefit tax guide (IR 409) - Jul 1997: *Explains fringe benefit tax obligations of anyone who is employing staff, or companies which have shareholder-employees. Anyone who registers as an employer with Inland Revenue will receive a copy of this booklet.*

GST - do you need to register? (GST 605) - May 1997: *A basic introduction to goods and services tax, which will also tell you if you have to register for GST.*

GST guide (GST 600) - Dec 1997: *An in-depth guide which covers almost every aspect of GST. Everyone who registers for GST gets a copy of this booklet. It is quite expensive for us to print, so we ask that if you are only considering GST registration, you get the booklet "GST - do you need to register?" instead.*

ir-File (IR 343) - Dec 1998: Explains the new electronic filing system for employers' monthly PAYE payments and information, introduced from April 1999.

IR 56 taxpayer handbook (IR 56B) - Mar 1998: *A booklet for part-time private domestic workers, embassy staff, nannies, overseas company reps and Deep Freeze base workers who make their own PAYE payments.*

Making payments (IR 87C) - Nov 1996: *How to fill in the various payment forms to make sure payments are processed quickly and accurately.*

PAYE deduction tables - 1999
- Weekly and fortnightly (IR 184X)
- Four-weekly and monthly (IR 184Y)
Tables that tell employers the correct amount of PAYE to deduct from their employees' wages from 1 July 1998.

Retiring allowances and redundancy payments (IR 277) - 1998: *An explanation of the tax treatment of these types of payments.*

Smart Business (IR 120) - May 1998: *An introductory guide to tax obligations and record keeping, for businesses and non-profit organisations.*

Taxes and the taxi industry (IR 272) - Feb 1996: *An explanation of how income tax and GST apply to taxi owners, drivers, and owner-operators.*

Resident withholding tax and NRWT

Approved issuer levy (IR 291A) - May 1995: *For taxpayers who pay interest to overseas lenders. Explains how you can pay interest to overseas lenders without having to deduct NRWT.*

Non-resident withholding tax payer's guide (IR 291) - Mar 1995: *A guide for people or institutions who pay interest, dividends or royalties to people who are not resident in New Zealand.*

Resident withholding tax on dividends (IR 284) - Feb 1998: *A guide for companies, telling them how to deduct RWT from the dividends that they pay to their shareholders.*

Resident withholding tax on interest (IR 283) - Jul 1996: *A guide to RWT for people and institutions which pay interest.*

Resident withholding tax on investments (IR 279) - Jun 1996: *An explanation of RWT for people who receive interest or dividends.*

Non-profit bodies

Charitable organisations (IR 255) - May 1993: *Explains what tax exemptions are available to approved charities and donee organisations, and the criteria which an organisation must meet to get an exemption.*

Clubs and societies (IR 254) - Feb 1998: *Explains the tax obligations which a club, society or other non-profit group must meet.*

Education centres (IR 253) - Jun 1994: *Explains the tax obligations of schools and other education centres. Covers everything from kindergartens and kohanga reo to universities and polytechnics.*

Gaming machine duty (IR 680A) - Jun 1997: *An explanation of the duty which must be paid by groups which operate gaming machines.*

Grants and subsidies (IR 249) - Jun 1994: *An guide to the tax obligations of groups which receive a subsidy, either to help pay staff wages, or for some other purpose.*

Company and international issues

Company amalgamations (IR 4AP) - Feb 1995:*Brief guidelines for companies considering amalgamation. Contains an IR 4AM amalgamation declaration form.*

Consolidation (IR 4E) - Mar 1993:*An explanation of the consolidation regime, which allows a group of companies to be treated as a single entity for tax purposes.*

Controlled foreign companies (IR 275) - Nov 1994:*Information for NZ residents with interests in overseas companies. (More for larger investors, rather than those with minimal overseas investments)*

Foreign dividend withholding payments (IR 274A) - Mar 1995: *Information for NZ companies that receive dividends from overseas companies. This booklet also deals with the attributed repatriation and underlying foreign tax credit rules.*

Foreign investment funds (IR 275B) - Oct 1994:*Information for taxpayers who have overseas investments, but who don't have a controlling interest in the overseas entity.*

Imputation (IR 274) - Dec 1997:*A guide to dividend imputation for New Zealand companies.*

Qualifying companies (IR 4PB) Oct 1992:*An explanation of the qualifying company regime, under which a small company with few shareholders can have special tax treatment of dividends, losses and capital gains.*

Child support booklets

A guide for parents who pay child support (CS 71A) - May 1998: *Information for parents who live apart from their children.*

Child support - a guide for custodians (CS 71B) - Nov 1997: *Information for parents who take care of children for whom child support is payable.*

Child support - a guide for prisoners (CS 288) - Mar 1998: *Information for prison inmates who have to pay child support..*

Child support administrative reviews - how to apply (CS 69A) - Feb 1998: *How to apply for a review of the amount of child support you receive or pay, if you have special circumstances.*

Child support administrative reviews - how to respond (CS 69B) - Apr 1998: *Information about the administrative review process, and how to respond if you are named in a review application.*

Child support and redundancy (CS 277) - Jul 1998:*An explanation of how becoming redundant can affect a paying parent's child support liability.*

Child support and the Family Court (CS 51) - Apr 1998:*Explains what steps people need to take if they want to go to the Family Court about their child support .*

Child support - estimating your income (CS 107G) - Aug 1997: *Explains how to estimate your income so your child support liability reflects your current circumstances.*

Child support - how the formula works (CS 68) - Dec 1996: *Explains the components of the formula and gives up-to-date rates.*

Child support is working for children (CS 80) - Mar 1998: *Brief summary of how child support works, plus some statistics on number of child support customers and amount collected/paid.*

Problems with our child support service? (CS 287) - Jul 1997: *Explains how our Problem Resolution Service can help if our normal services haven't resolved your child support problems.*

Depreciation determinations issued since last update of IR 260 Depreciation booklet

This list shows all depreciation determinations we've issued since the last update of our Depreciation booklet (IR 260). It will enable you to check quickly whether you need to review any determinations when calculating depreciation for tax purposes.

Some determinations cover a large number of assets which will concern relatively few taxpayers. For these determinations we've simply listed a cross-reference to the original TIB article rather than reproduce several pages of figures here.

This list is essentially a summary; if you're claiming depreciation on any of these assets we recommend that you refer to the original TIB article to make sure you get the full context of the determination, including the relevant industry categories.

We publish this list in the TIB every March, June, September and December. Updates are available at other times from TIBs on our website at:

http://www.ird.govt.nz.

Asset	Estimated useful life (years)	DV banded depreciation rate (%)	SL equivalent banded dep'n rate (%)	Determination number	Appears in TIB
Aquariums	4	40	30	DEP22	9.2:1
Automotive tools *(various – see TIB article)*				DEP30	9.11:2
Bakery utensils (incl. pots and pans)	3	50	40	DEP30	9.11:2
Bedding (Hotels, Motels, etc, and medical/lab)	3	50	40	DEP30	9.11:3,4
Bedding (medical and medical laboratories)	3	50	40	DEP30a	10.3:5

Bin (wool storage, live bottom)	15.5	12	8	DEP11	7.3:20
Bird netting (winegrowers)	5	33	24	DEP42	10.9:6
Books, published annually or more frequently	2	63.5	63.5	DEP32	10.3:3
Books, other	10	18	12.5	DEP32	10.3:3
Bulkheads (insulated, removable)	4	40	30	DEP13	7.10:26
CCH Electronic NZ Essential Tax Package, designed for a specific tax year	1	100	100	PROV4	7.3:19
CCH Electronic NZ Master Tax Guide, designed for a specific tax year	1	100	100	PROV4	7.3:19
Combing machines (wool)	15.5	12	8	DEP11	7.3:20
Comparators (consumer electronics comparative display units)	3	50	40	DEP39	10.8:3
Computer numerically-controlled drilling & routing machine (timber/joinery industry)	8	22	15	DEP33	10.4:40
Computer numerically-controlled tooling machine (timber/joinery industry)	8	22	15	DEP28	9.9:1
Containers (insulated, below $8m^3$)	5	33	24	DEP13	7.10:26
Containers (shipping)	20	9.5	6.5	DEP13	7.10:26
Crayfish (baby) – peurulus traps	1	100	100	PROV7	10.7:4
Crown Health Enterprise assets *(half a page of various assets - see TIB article)*					6.5:7
Dance floor	20	9.5	6.5	DEP30	9.11:3
Delimbers, self-propelled, mobile (timber industry)	8	22	15.5	DEP35	10.6:5
Drilling & routing machine, computer numerically-controlled (timber/joinery industry)	8	22	15	DEP33	10.4:40
Drilling machines (horizontal directional)	6.66	26	18	DEP24	9.3:3
Drilling machine components, underground (horizontal directional)	2	63.5	63.5	DEP24	9.3:3
Electricity revenue and data logging terminals *(two rates - see TIB article)*				DEP41	10.9:5
Electronic article surveillance systems	5	33	24	DEP26	9.6:3
Engineering tools *(various – see TIB article)*				DEP30	9.11:2
Fastening guns (explosive)	3	50	40	DEP20	8.10:1
Firearms (Leisure industry category)	10	18	12.5	DEP20	8.10:1
Gas cylinders – LPG (incl. propane and butane)	8	22	15.5	DEP16	8.1:10
Gas cylinders – other	12.5	15	10	DEP16	8.1:10
Gill machines (wool)	20	9.5	6.5	DEP11	7.3:20
Golf ball placing machine and sensor	3	50	40	DEP10	7.3:18
Golf driving ranges, netting (for golf driving nets)	5	33	24	DEP10	7.3:18
Golf driving ranges, poles (for golf driving nets)	20	9.5	6.5	DEP10	7.3:18
Golf mats (stance and base, at golf driving/practice ranges)	2	63.5	63.5	DEP10	7.3:18
Hand soap dispensers	2	63.5	63.5	DEP7	6.7:16
Hi-trim shelter trimmers	10	18	12.5	DEP40	10.9:4
Hydrogen manufacturing unit and hydrocracker catalysts (oil/gas industry) (various rates – see TIB article)				DEP37	10.7:3
Ink mixing systems, computerised	3	50	40	DEP27	9.8:2
"Kiwiplus" – kiwifruit packhouse software	1	100	100	PROV6	9.6:8
Lawnmowers (domestic type in use by lawnmowing contractors)	2	63.5	63.5	DEP15	7.13:22
Lawnmowers (non-domestic type in use by lawnmowing contractors	5	33	24	DEP15	7.13:22
Machine centre, CNC (timber/joinery industry)	8	22	15	DEP28	9.9:1
Marquees *(half a page of various assets – see TIB article)*				DEP18	8.6:8
Medical and medical laboratory equipment *(3 pages of various assets – see TIB article)*				DEP8	6.7:17
Motor vehicles rented for 1 month or less *(various rates – see TIB article)*				DEP34	10.6:3
Mulch – woven reflective	3	50	40	DEP38	10.7:4
Mulchers (commercial)	4	40	30	DEP25	9.6:6
Newspapers		expense	expense	DEP32	10.3:3
Paintball firearms	2	63.5	63.5	DEP20	8.10:1
Pallet covers (insulated)	2	63.5	63.5	DEP13	7.10:26
Paper towel dispensers	2	63.5	63.5	DEP7	6.7:16
Pistols, Air (Leisure industry category)	10	18	12.5	DEP20	8.10:1

Plant trolleys	5	33	24	DEP23	9.3:2
Psychological testing sets	10	18	12.5	PROV2	6.10:6
Rams (hydraulic or pneumatic)	3	33	24	DEP30	9.11:3
Residential rental property chattels *(various – see TIB article)*				DEP30	9.11:3
Rifles, Air (Leisure industry category)	10	18	12.5	DEP20	8.10:1
Rifles (less than 10,000 rounds per year)	6.66	26	18	DEP20	8.10:1
Rifles (more than 10,000 rounds per year)	2	63.5	63.5	DEP20	8.10:1
Scaffolding (aluminium)	8	22	15.5	DEP19	8.8:3
Scaffolding (other than aluminium)	15.5	12	8	DEP19	8.8:3
Scientific and laboratory equipment (not medical laboratory equipment) *(2 pages of various assets – see TIB article)*				DEP8	6.7:17
Shop utensils (incl pots and pans)	3	50	40	DEP30	9.11:3
Shotguns (less than 50,000 rounds per year)	6.66	26	18	DEP20	8.10:1
Shotguns (more than 50,000 rounds per year)	2	63.5	63.5	DEP20	8.10:1
Skidoo	5	33	24	DEP30	9.11:3
Sound recordings (copyright in)	1	100	100	DEP31	10.3:2
Speed humps (metal)	5	33	24	PROV3	6.13:13
Stage	20	9.5	6.5	DEP30	9.11:3
Static delimbers (timber industry)	5	33	24	DEP9	6.11:16
Tags (security)	3	50	40	DEP21	9.1:1
Toilet roll dispensers	2	63.5	63.5	DEP7	6.7:16
Tomato graders	8	22	15.5	DEP14	7.13:23
Tooling machine, CNC (timber/joinery industry)	8	22	15	DEP28	9.9:1
Trailers (class TD – over 10 tonnes) – when rented for periods of one month or less	10	18	12.5	DEP29	9.11:1
Undersea maintenance equipment *(1 page of various assets – see TIB article)*				DEP17	8.2:9
Wind turbine generators	10	18	12.5	DEP36	10.6:6
Windmills	10	18	12.5	DEP36	10.6:6
Wintering pads (rubber)	6.66	26	18	PROV5	8.2:7
Yachts (international ocean-going)	6	15	10	DEP12	7.10:25
Yachts (other than international ocean-going)	15.5	12	8	DEP12	7.10:25

Due dates reminder

January 1999

7 Annual income tax returns due to be filed for all non-IR 5 taxpayers with September balance dates.

1998 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with February balance dates.

QCET payment due for companies with February balance dates, if election is to be effective from the 1999 year.

15 Large employers: PAYE deductions and deduction schedules for period ended 31 December 1998 due.

GST return and payment for period ended 30 November 1998 due.

Provisional tax and/or Student Loan interim repayments: first 1999 instalment due for taxpayers with September balance dates.

Second 1999 instalment due for taxpayers with May balance dates.

Third 1999 instalment due for taxpayers with January balance dates.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 January 1999 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 December 1998 due.

FBT return and payment for quarter ended 31 December 1998 due.

Gaming machine duty return and payment for month ended 31 December 1998 due.

RWT on interest deducted during December 1998 due for monthly payers.

RWT on dividends deducted during December 1998 due.

Non-resident withholding tax (or approved issuer levy) deducted during December 1998 due.

29 GST return and payment for period ended 31 December 1998 due.

February 1999

5 Large employers: PAYE deductions and deduction schedules for period ended 31 January 1999 due.

7 Provisional tax and/or Student Loan interim repayments: first 2000 instalment due for taxpayers with October balance dates.

Second 1999 instalment due for taxpayers with June balance dates.

Third 1999 instalment due for taxpayers with February balance dates.

1998 end of year payments due (income tax, Student Loans, ACC premiums) for taxpayers with balance dates in period March-September.

(We will accept payments received or posted on Monday 8 February 1999 as in time for 7 February.)

QCET payment due for companies with balance dates in period March-September, if election is to be effective from the 1999 year.

20 Large employers: PAYE deductions and deduction schedules for period ended 15 February 1999 due.

Small employers: PAYE deductions and deduction schedules for period ended 31 January 1999 due.

Gaming machine duty return and payment for month ended 31 January 1999 due.

RWT on interest deducted during January 1999 due for monthly payers.

RWT on dividends deducted during January 1999 due.

Non-resident withholding tax (or approved issuer levy) deducted during January 1999 due.

(We will accept payments received or posted on Monday 21 February 1999 as in time for 20 February.)

26 GST return and payment for period ended 31 January 1999 due.

Public binding rulings and interpretation statements: your chance to comment before we finalise them

This page shows the draft public binding rulings and interpretation statements that we now have available for your review. You can get a copy and give us your comments in three ways:

By post: Tick the drafts you want below, fill in your name and address, and return this page to the address below. We'll send you the drafts by return post. Please send any comments *in writing, to the address below*. We don't have facilities to deal with your comments by phone or at our local offices.

From our main offices: Pick up a copy from the counter at our office in Takapuna, Manukau, Hamilton, Wellington, Christchurch or Dunedin. You'll need to post your comments back to the address below; we don't have facilities to deal with them by phone or at our local offices.

On the Internet: Visit our website at http://www.ird.govt.nz/rulings/ Under the "Adjudication & Rulings" heading, click on "Draft Rulings", then under the "Consultation Process" heading, click on the drafts that interest you. You can return your comments via the Internet.

Name ____________________

Address ____________________

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✓	*Public binding rulings*	*Comment Deadline*
☐	**0042:** Frequent flyer schemes promoted by credit card companies – fringe benefit tax liability	28 February 1999
☐	**3289:** Car parks provided by employers – fringe benefit tax exemption	28 February 1999

We must receive your comments by the deadline shown if we are to take them into account in the finalised item

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